Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

SHEA & GOULD and SHELDON CAMHY,

Petitioners,

vs.

RONALD L. DURKIN, Trustee of the Benchmark Irrevocable Trust,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether a final judgment, entered after proceedings under Rules 23 and 23.1 of the Federal Rules of Civil Procedure approving a derivative litigation settlement with a specific finding that the settlement was fair, reasonable and adequate as to Imperial Corporation of America ("ICA"), bars subsequent actions attacking the fairness, reasonableness and adequacy of the settlement to ICA.

2. Whether the findings in a federal judgment that the derivative action settlement was fair, reasonable and adequate to ICA and that ICA was adequately represented in the derivative action bar a subsequent action for professional negligence and breach of fiduciary duty against the attorneys for ICA for allegedly allowing ICA to enter an inadequate settlement where it is undisputed that the requirements of Rules 23 and 23.1 were met and where there are no allegations of fraud on the rendering court.

PARTIES TO THE PROCEEDINGS

The parties to the underlying action, *Durkin v. Shields*, Case No. 92-1003, pending in the United States District Court for the Southern District of California (the "*Durkin* action"), are:

Respondent Ronald L. Durkin, Trustee of the Benchmark Irrevocable Trust ("Benchmark"). Benchmark is the alleged successor-in-interest of ICA and was created through ICA's plan of reorganization;

Petitioners Shea & Gould and Sheldon Camhy (collectively, "Shea & Gould");

Other parties to the *Durkin* action, who are not parties to this appeal: Rodney B. Shields, Three Bridges Investment Group, Max Grill, William Steiner, Sonem Partners,[1] Milberg Weiss Bershad Specthrie & Lerach (now known as Milberg Weiss Bershad Hynes & Lerach), William S. Lerach, Keith F. Park, Helen J. Hodges, Alan Schulman, Greenfield & Chimicles, Richard D. Greenfield, Francis J. Firana, Kevin P. Roddy, Barrack, Rodos & Bacine, Leonard Barrack, Edward M. Gergosian, Douglas J. Campion, Gerald J. Rodos, Berger & Montague, P.C., Sherrie R. Savett, David Richman, Stull, Stull & Brody, Jules Brody, Goodkind, Labaton & Rudoff, Lawrence Sucharow, Clemens, Glassman and Clemens, Michael S. Glassman, Rabin & Sirota, Howard Sirota, Schiffrin & Craig, Richard Schiffrin,[2] Kenneth J. Thygerson, Kevin E. Villani,

---

1. Rodney B. Shields, Three Bridges Investment Group, Max Grill, William Steiner and Sonem Partners were shareholders of ICA and were the plaintiffs in the underlying derivative litigation. Hereafter, they will be referred to collectively as the "Shareholder Plaintiffs."

2. Milberg, Weiss, Bershad, Specthrie & Lerach, William S. Lerach, Keith F. Park, Helen J. Hodges, Alan Schulman, Greenfield & Chimicles, Richard D. Greenfield, Francis J. Firana, Kevin P. Roddy, Barrack, Rodos & (Cont'd)

Rocco J. Fabiano, Stephen M. Wright, Robert E. Alshuler, Richard A. Archer, Gary M. Cypres, Victor N. Goulet, Stuart I. Greenbaum, Lyman C. Hamilton, Jr., John W. Kenney, Allan R. Tessler,[3] Kurt Hunciker, Baker & McKenzie, Charles H. Dick, Jr. and American Casualty Company of Reading Pennsylvania.

STATEMENT OF CORPORATE DISCLOSURE

Petitioners are not corporations and therefore have no parents or subsidiaries.

(Cont'd)

Bacine, Leonard Barrack, Edward M. Gergosian, Douglas J. Campion, Gerald J. Rodos, Berger & Montague, P.C., Sherrie R. Savett, David Richman, Stull, Stull & Brody, Jules Brody, Goodkind, Labaton & Rudoff, Lawrence Sucharow, Clemens, Glassman and Clemens, Michael S. Glassman, Rabin & Sirota, Howard Sirota, Schiffrin & Craig and Richard Schiffrin represented the Shareholder Plaintiffs in the underlying derivative litigation. Hereafter, they will be collectively referred to as the "Shareholders' Counsel."

3. Kenneth J. Thygerson, Kevin E. Villani, Rocco J. Fabiano, Stephen M. Wright, Robert E. Alshuler, Richard A. Archer, Gary M. Cypres, Victor N. Goulet, Stuart I. Greenbaum, Lyman C. Hamilton, Jr., John W. Kenney and Allan R. Tessler were directors or officers of ICA and ICA's thrift subsidiary, Imperial Savings Association ("Imperial Savings"), and were the defendants in the underlying derivative litigation. Hereafter, they will be referred to collectively as the "ICA Directors and Officers." Robert E. Alshuler, Richard A. Archer, Gary M. Cypres, Victor N. Goulet, Stuart I. Greenbaum, Lyman C. Hamilton, Jr., John Kenney and Allan R. Tessler were outside directors and will be referred to collectively as "ICA Directors."

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Petitioners Shea & Gould and Sheldon Camhy respectfully request that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this matter on August 19, 1996, and for which a petition for rehearing with an *en banc* suggestion was denied on November 25, 1996.

OPINIONS BELOW

(1) Order Denying Shea Defendants' Motion For Summary Judgment, etc. filed July 12, 1994. This unpublished opinion is reprinted in the appendix to this petition, pp. 1a-13a; (2) Order Granting Defendants' Motion To Certify Decision For Interlocutory Appeal, filed December 8, 1994. This unpublished opinion is reprinted in the appendix to this petition, pp. 14a-20a; (3) Court of Appeals' Order Granting Petition To Appeal Pursuant To 28 U.S.C. § 1292(b). This unpublished opinion is reprinted in the appendix to this petition, pp. 21a-22a; (4) *Durkin v. Shea & Gould*, 92 F.3d 1510 (9th Cir. 1996). This published opinion is reprinted in the appendix to this petition, pp. 23a-41a; (5) The Court of Appeals' judgment entered on August 19, 1996. This unpublished opinion is reprinted in the appendix to this petition, pp. 42a-43a; (6) The Court of Appeals' Order Denying Appellant's Petition For Rehearing, filed November 25, 1996. This unpublished opinion is reprinted in the appendix to this petition, pp. 44a-45a; and (7) *In re Imperial Corp. of America*, 92 F.3d 1503 (9th Cir. 1996). This published opinion is reprinted in the appendix to this petition, pp. 46a-61a.

STATEMENT OF JURISDICTION

The judgment of the Court of Appeals was entered on August 19, 1996. On September 9, 1996, petitioners filed a petition for rehearing with a suggestion for a hearing *en banc*. The Court of Appeals denied the petition for rehearing on November 25,

1996. The jurisdiction of the Court is invoked pursuant to 28 U.S.C. § 1254(1).

RULE INVOLVED

This case involves the preclusive effect of findings set forth in a judgment entered by a United States District Court made in proceedings under Rule 23.1 of the Federal Rules of Civil Procedure. The text of Rule 23.1 is reprinted in the appendix to this petition at p. 63a.

STATEMENT OF THE CASE

This case raises the question of whether a federal judgment entered in consolidated shareholder class and derivative actions may be collaterally attacked.[4] The rendering district court entered the judgment after months of court-supervised settlement negotiations. Before the judgment was entered, in accordance with Rules 23 and 23.1 of the Federal Rules of Civil Procedure, the court found that: (i) the case was a proper derivative action prosecuted by the Shareholder Plaintiffs on ICA's behalf; (ii) ICA was adequately represented by the Shareholder Plaintiffs and their counsel; (iii) the proposed settlement was the product of good faith arm's length negotiations by the parties; and (iv) the settlement negotiated among the Shareholder Plaintiffs, the defendants — ICA's management and board of directors — and ICA's insurers was fair, reasonable and adequate as to ICA.

Two years later, respondent, ICA's alleged successor-in-interest, sued everyone involved with the settlement, save the court itself, on theories of breach of fiduciary duty and

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4. The prior litigation involved five shareholder derivative actions and a shareholder class action. All six cases were consolidated before a single judge. The lead case in the prior litigation was *Shields v. Thygerson*. Hereafter, the prior litigation will be referred to as the "*Shields* action."

professional negligence. The gravamen of the case below is that the court-approved derivative action settlement was in fact *un*fair, *un*reasonable and *in*adequate as to ICA.

A. The Underlying *Shields* Action

Between January and December 1989, the Shareholder Plaintiffs filed actions in the Southern District of California derivatively on behalf of ICA against ICA's Directors and Officers. Seasoned shareholder litigation firms represented the Shareholder Plaintiffs. (CR 237 at 6-12, 16-21, 1 ER 9-12, 19-24; CR 537 at 5-10, 17-20, 3 ER 588-593, 600-603.)[5] There were five derivative actions, each brought by independent counsel. The central claim in each action was that ICA's officers and directors had mismanaged ICA by allowing its thrift subsidiary, Imperial Savings, to engage in non-traditional thrift investments such as bulk consumer loans and high-yield bonds.[6]

Experienced counsel from several law firms led the defense. Luce, Forward, Hamilton & Scripps represented the ICA Directors. (CR 537 at 24, 3 ER 607; CR 490 at Ex. U, 2 ER 469.) Seltzer, Caplan, Wilkins & McMahon represented ICA's Chief Executive Officer and Chief Financial Officer. (CR 490 at Ex. U, 2 ER 469.) Gibson, Dunn & Crutcher represented another officer. (CR 490 at Ex. W, 2 ER 518.) Baker & McKenzie represented ICA. (CR 490 at Ex. U, 2 ER 469-70; CR 537 at

---

5. "CR" refers to the Clerk's Record. "ER" refers to the excerpts of record filed with the Court of Appeals.

6. In its rendition of the dispute, the Court of Appeals stated that the *Shields* action "arose from transactions with Michael Milken and Drexel Burnham Lambert in the late 1980s." *Durkin v. Shea & Gould*, 92 F.3d 1510, 1512 (9th Cir. 1996). Respondent, however, never alleged (nor is there evidence of) transactions involving Milken. Drexel had no involvement in bulk consumer loan investments by ICA, and was only as one of several underwriters of the bond investments.

14, 24, 3 ER 597, 607, 632.) Shea & Gould was not ICA's counsel of record. ICA retained Shea & Gould to assist in settlement negotiations along with its counsel of record, Baker & McKenzie. (CR 490 at Ex. F, 2 ER 351; CR 537 at 12, 25, 49, 3 ER 595, 608, 632.)

Settlement discussions began early in the case. Between late October and early December 1989, negotiations intensified under the district court's active management. The Shareholder Plaintiffs and the defendants entered into a Stipulation of Settlement dated December 8, 1989 ("Proposed Settlement") which, if approved by the court, would resolve the derivative claims on behalf of ICA against ICA's Directors and Officers. The parties then pursued the Proposed Settlement's approval from the court under Rule 23.1 (and Rule 23 as to the class claims). (CR 237 at 24-26, 1 ER 27-29; CR 463 at 83, 87, 1 ER 207, 211; CR 537 at 27-29, 3 ER 610-612.) Federal regulators were promptly notified of the impending settlement.

On January 11, 1990, the court issued an order directing that notice of the Proposed Settlement be sent to shareholders. (CR 463 at 83, 1 ER 207.) The court scheduled a hearing for February 22 to determine whether the Proposed Settlement should be approved. (CR 237 at 29, 1 ER 32; CR 463, 1 ER 207; CR 537 at 32-33, 3 ER 615-16.)

Before the February 22 hearing, the Shareholder Plaintiffs briefed the settlement's adequacy to the court. (CR 463 at 87, 1 ER 211; CR 490 at Ex. V, 2 ER 472.) They also informed the court of the objections made to the settlement in response to the notice. (CR 490 at Ex. V, 2 ER 507-10.)

On February 22, the motion to approve the settlement came before the court. (CR 463 at 83, 1 ER 207; CR 490 at Ex. W, ER 515.) The court considered the objections and rejected them.

(CR 490 at Ex. W, 2 ER 530-32.) The court approved the Proposed Settlement and signed a judgment dismissing the *Shields* action (CR 463 at 89, 1 ER 213), declaring that the settlement "could serve as a model for how this complex litigation could be handled, not only in San Diego and the Southern District of California, but throughout the country." (CR 490 at Ex. W, 2 ER 520.)

The judgment provided that:

> (i) the Shareholder "Plaintiffs are appropriate derivative case fiduciaries and it is appropriate for this case to proceed as a derivative action on behalf of Imperial." (CR 463 at 85-6, 1 ER 209-10);
>
> (ii) the notice of the Proposed Settlement "constitutes the best notice practicable under the circumstances and includes individual notice to all members of the Class and all holders of Imperial Corporation of America common stock on January 10, 1990, who could be identified by reasonable effort . . . , complying fully with Rules 23 and 23.1 of the Federal Rules of Civil Procedure." (CR 463 at 86-7, 1 ER 210-11);
>
> (iii) the Proposed Settlement "is the product of good faith arm's length negotiations by the parties thereto." (CR 463 at 87, 1 ER 211);
>
> (iv) the Proposed Settlement is "fair, reasonable and adequate as to . . . Imperial and their [sic] shareholders . . ." (CR 463 at 89, 1 ER 213); and

> (v) the Shareholder Plaintiffs and the defendants in the derivative actions "have fully complied with Rules 23 and 23.1 of Federal Rules of Civil Procedure of [sic] this Litigation and due and adequate notice of the settlement has been provided to members of the Class and holders of Imperial Corporation of America common stock on January 10, 1990." (CR 463 at 93, 1 ER 217.)

Unknown to the *Shields* court and the settling parties, on the day of the final approval hearing, federal regulators in Washington secretly issued orders to appoint a conservator for Imperial Savings under FIRREA.[7] The next day, the Office of Thrift Supervision ("OTS") placed Imperial Savings into conservatorship, forcing ICA to seek bankruptcy protection. (CR 237 at 31, 1 ER 34; CR 537 at 35, 3 ER 618.) Later, ICA's reorganization plan created a common law trust, Benchmark, as a vehicle for liquidating assets and claims for the benefit of ICA's creditors. Respondent is Benchmark's creditor-nominated trustee.[8]

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7. During 1989, the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), which made enormous changes in federal thrift regulation, was enacted. FIRREA's effect on ICA as well as the rest of the industry was "swift and severe." *United States v. Winstar*, __ U.S. __, 116 S. Ct. 2432, 2446 (1996). Regulations under FIRREA forced ICA to immediately "write down" Imperial Savings' investments, deprived it of the use of goodwill and otherwise impaired its regulatory capital. ICA was, therefore, working with the regulators to develop a capital plan under the new rules. ICA's travails were widely publicized in the news media and before the *Shields* court. Indeed, the need to resolve the pending shareholder litigation so as to improve ICA's financial condition in the eyes of the federal regulators was a factor motivating ICA to settle the *Shields* action, and the *Shields* court alluded to this in its remarks at the final approval hearing. (CR 490 at Ex. W, 2 ER 529.)

8. Despite ample evidence in the record to the contrary, the Court of (Cont'd)

B. Procedural History

1. Jurisdiction Of The District Court And The Court Of Appeals

The district court has jurisdiction under: 28 U.S.C. § 157(c)(1); 28 U.S.C. §§ 1334(b), 2201 and 2202; and 11 U.S.C. §§ 105, 362, 547, 548, 549 and 558. The Court of Appeals had jurisdiction over this matter under 28 U.S.C. § 1292(b).

2. Proceedings In The District Court

On February 21, 1992, almost two years after the *Shields* judgment, respondent filed this action and initially named as defendants: the Shareholder Plaintiffs who brought the derivative actions, the Shareholders' Counsel, the former ICA Directors and Officers, and ICA's directors' and officers' insurance carriers, CNA/American Casualty Company and Reliance Insurance Company. (CR 1; CR 237 at 47, 1 ER 50.) Respondent's initial attack on the *Shields* judgment included an attempt to avoid the judgment and hold those defendants liable for breach of fiduciary duty to ICA for settling the *Shields* action. (CR 1.)

(Cont'd)

Appeals apparently accepted respondent's characterization of the settlement as an effort "to push a quick settlement through the court *before* the seizure and bankruptcy." *Durkin*, 92 F.3d at 1517 (emphasis in original). This pejorative characterization of the events has no factual support and is contradicted by the following ***undisputed*** facts: (1) the settlement process, which included court supervised settlement negotiations, occurred over a period of months — it was not a "quick settlement;" (2) the OTS seized Imperial Savings without advance notice; (3) ICA's bankruptcy filing was a *direct result of* the OTS' surprise seizure; and (4) on January 11, the district court — not the parties — set the February 22 date for final approval of the settlement. The settlement was negotiated under court supervision, and the district court set the final approval hearing long before the OTS ordered the seizure.

After the district court dismissed respondent's avoidance claims (CR 38), respondent amended his complaint to add a claim against Shea & Gould.[9] (CR 67.) Respondent alleged that Shea & Gould and ICA's counsel of record, Baker & McKenzie, breached alleged duties of care in allowing a settlement that was unfair and inadequate to ICA. (CR 67; CR 237 at 37-38, 1 ER 40-41.)

Shea & Gould moved for summary judgment, arguing that the *Shields* judgment barred respondent's alleged claims under the issue preclusion doctrine since the judgment specifically found: (i) the settlement was fair, reasonable and adequate to ICA and (ii) the Shareholder Plaintiffs properly represented ICA's interests in the derivative claims. (CR 460-62, 1 ER 81-121.) The district court denied the motion, stating that issue preclusion did not apply because "plaintiff was not provided with a full and fair opportunity to litigate the adequacy of the settlement." (CR 522 at 5-6, 2 ER 563-64.) The district court also ruled that Shea & Gould could not avail itself of issue preclusion because of respondent's allegation that the *Shield's* judgment resulted from legal malpractice. (CR 522 at 6-7, 2 ER 564-65.)

The district court certified for interlocutory appeal the issue of the *Shields* judgment's preclusive effect. (CR 573; CR 731 at 7, 3 ER 662.) The Court of Appeals granted Shea & Gould permission to appeal under 28 U.S.C. § 1292(b) on April 6, 1995. (CR 840, 3 ER 663.)

On July 19, 1995, the district court stayed the case below,

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9. Respondent has also sued Baker & McKenzie and Charles H. Dick, ICA's counsel of record in the *Shields* action, on substantially identical claims. (CR 537 at 49-53, 3 ER 632-36.)

along with the other consolidated cases that had been filed in its wake, pending the resolution of the interlocutory appeal before the Ninth Circuit. (3 ER 666-71.)

REASONS FOR GRANTING THE WRIT

This case threatens the finality of federal judgments in cases considered among the most complex, expensive and time consuming — shareholder derivative actions.[10] Nearly all shareholder suits (derivative and class actions)[11] are resolved through judicially-approved settlements. The ability to resolve such cases through settlement, rather than through a full trial on the merits, is essential to the judicial system and the parties involved. Consequently, courts consistently have given broad preclusive effect to settlements of shareholder actions.

The Court of Appeals' holding conflicts with the many cases giving broad preclusive effect to such settlements. The holding allows these settlements to be swept aside and attacked collaterally, merely by cloaking the collateral attack under the rubric of "professional negligence" or "breach of fiduciary duty." Stripped of these labels, respondent's case is revealed as a direct assault on the key findings in the *Shields* judgment: (i) the adequacy of the settlement and (ii) the adequacy of the representation of ICA in the *Shields* action. To prevail, respondent must relitigate every issue resolved in the *Shields* action and prove that the *Shields* court's specific finding that the prior settlement was fair, reasonable and adequate was erroneous.

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10. Derivative litigation is "notoriously difficult and unpredictable." *Maher v. Zapata Corp.*, 714 F.2d 436, 455 (5th Cir. 1983).

11. The procedural issues and policy concerns germane to this case also arise in shareholder class actions, which are controlled by Rule 23 of the Federal Rules of Civil Procedure. The procedural safeguards concerning settlement under Rules 23 and 23.1 are identical.

Defendants in shareholder litigation would never settle if they later could be sued for "breach of fiduciary duty." No insurer would fund such a settlement if it or its insured could be sued and forced to pay again. Attorneys would never counsel settlement if they later could be sued for malpractice by anyone who disagrees with the settlement's fairness even though a federal judge has independently determined its fairness.

A conflict among the circuits now exists on this question of vital importance to the federal judiciary: the finality of settlements entered in shareholder litigation. The Court of Appeals' decision joins a recent Eleventh Circuit decision in allowing collateral attacks on court-approved settlements in representative suits. As a result of this case and the Eleventh Circuit decision, Judge Easterbrook of the Seventh Circuit recently opined that derivative and class action settlements are subject to collateral attack on such grounds even though such settlements have been approved by federal courts as fair. Cases from other circuits and the Supreme Court, however, have given derivative and class action settlements broad preclusive effect to preserve finality against collateral attacks, even where the attack poses as a "malpractice" claim. Certiorari should be granted to resolve the growing conflict and stem the attack on the finality of judgments in representative actions.

I. THE FINALITY OF SETTLEMENTS AND JUDGMENTS IN SHAREHOLDER LITIGATION IS A MATTER OF GREAT IMPORTANCE TO THE FEDERAL JUDICIARY.

There is a "strong judicial policy that favors settlement," especially in complex derivative and class actions. *In re Pacific Enterps. Sec. Litig.*, 47 F.3d 373, 378 (9th Cir. 1995).[12]

12. In general, "public policy favors voluntary settlements which obviate (Cont'd)

"Complex litigation — like [derivative and class actions] — can occupy a court's docket for years on end, depleting the resources of the parties and the taxpayers while rendering meaningful relief increasingly elusive." *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 493 (11th Cir. 1992). Another court observed:

> It hardly seems necessary to point out that there is an overriding public interest in settling and quieting litigation. This is particularly true in class action suits which are now an ever increasing burden to so many federal courts and which frequently present serious problems of management and expense.

Valerio v. Boise Cascade Corp., 80 F.R.D. 626, 649 (N.D. Cal. 1978) (quoting *Van Bronkhorst v. Safeco Corp.*, 529 F.2d 943 (9th Cir. 1976) (footnotes omitted); *United States v. McInnes*, 556 F.2d 436 (9th Cir. 1977)), *aff'd*, 645 F.2d 699 (9th Cir. 1981), *cert. denied*, 454 U.S. 1126 (1981).[13]

(Cont'd)
the need for expensive and time-consuming litigation." *Bass v. Phoenix Seadrill/78, Ltd.*, 749 F.2d 1154, 1164 (5th Cir. 1985). "The law favors settlement. It is indeed the preferred means of dispute resolution, particularly in complex class action litigation. . . ." *In re Wash. Pub. Power Supply Sys. Sec. Litig.*, 720 F. Supp. 1379, 1387 (D. Ariz. 1989), *aff'd, Class Plaintiffs v. Seattle*, 955 F.2d 1268 (9th Cir. 1992); *accord Cotton v. Hinton*, 559 F.2d 1326, 1331 (5th Cir. 1977) ("Particularly in class action suits, there is an overriding public interest in favor of settlement.")

13. The utility of settlements in representative litigation is reflected in the pending amendments to Rule 23, which specifically recognize the practice of certifying cases as class actions for settlement purposes only, even for cases that could not be certified for purposes of trial. Proposed Fed. R. Civ. P. 23(b)(4).

Settlement is especially beneficial to the parties to shareholder actions. "Settlements of shareholder derivative actions are particularly favored because such litigation is 'notoriously difficult and unpredictable.' " *Maher*, 714 F.2d at 455 (citations omitted); *accord Republic Nat'l Life Ins. Co. v. Beasley*, 73 F.R.D. 658, 667 (S.D.N.Y. 1977). They are also favored because ongoing shareholder litigation is tremendously expensive and because of "the distraction of corporate officers from their assigned duties in furtherance of the corporate well being." *See Maldonado v. Flynn*, 573 F. Supp. 684, 685 (S.D.N.Y. 1983).

As a result of the benefits to the judicial system and the parties, nearly all representative actions filed by shareholders against publicly traded corporations are resolved through judicially-approved settlements. *See In re Wells Fargo Sec. Litig.*, 157 F.R.D. 467, 476 (N.D. Cal. 1994).

Threatening these benefits to the judicial system, the Court of Appeals' decision has restricted the preclusive effect of settlements in such actions. As a court observed in dismissing a collateral attack on a court-approved settlement: "[R]estricting the *res judicata* effect of class action settlements would lessen a defendant's incentive to settle." *Valerio*, 80 F.R.D. at 649.

Respondent has sued the original parties to the *Shields* settlement, along with the insurers that funded the settlement and lawyers for the parties. To prove that the settlement was inadequate, respondent must relitigate the merits of the *Shields* action. In the process, respondent has and will continue to engage in all the litigation that was avoided by the *Shields* settlement. Scores of witnesses have been deposed in five track depositions, with hundreds of depositions anticipated. The parties have already designated more than 30 expert witnesses (with more to come), many of whom will give opinions concerning the issues raised, settled and dismissed in the *Shields*

action. Three million documents have been produced. The case is so cumbersome that (while the case was not affected by a stay) a Magistrate Judge was required to meet regularly with the dozens of lawyers who represent the various parties just to keep the mammoth discovery and pre-trial process from spinning completely out of control. The ultimate irony of the litigation below is that the parties to the *Shields* action settled, in part, *precisely to avoid* the millions of dollars in litigation costs and fees and tens of thousands of hours that have been and will be consumed in this litigation.[14]

The facts of this case are not novel or even uncommon for derivative action settlements. Here, respondent complains that Shea & Gould was sympathetic to the interests of the members ICA's management. Courts recognize that counsel hired by management to represent the company will naturally have an affinity with management. *See In re Oracle Sec. Litig.*, 829 F. Supp. 1176, 1188 (N.D. Cal. 1993) ("[I]n-house attorneys are inevitably subservient to the interests of the defendant directors and officers whom they serve."); *Breswick & Co. v. Briggs*, 135 F. Supp. 397, 403 (S.D.N.Y. 1955) ("It is not to be expected that the lawyer representing the corporation will be unfriendly with the directors thereof or their counsel.") Rule 23.1 procedures are designed with this natural relationship in mind. The type of collateral attack waged in this case threatens virtually every derivative action settlement, and attacks the core of the procedural safeguards of Rules 23 and 23.1.

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14. It was estimated that the litigation below was consuming the parties' resources at a rate of $1 million per month. In early 1995, the counsel for the ICA Directors filed a declaration stating that the ICA Directors and Officers defendants alone had already incurred $7 million in defense costs and fees. (3 ER 669.)

II. THE COURT OF APPEALS' DECISION CONFLICTS WITH DECISIONS OF OTHER FEDERAL COURTS GIVING BROAD PRECLUSIVE EFFECT TO SETTLEMENTS IN REPRESENTATIVE LITIGATION.

As a result of the benefits of settlements of representative actions and the strong judicial policy favoring their settlement, courts have given judicially-approved settlements in derivative cases and related shareholder class actions broad preclusive effect.[15] The Court of Appeals' decision conflicts with these cases.

In 1954, the Second Circuit explained:

> The judicial scrutiny contemplated by [former] F.R.C.P. 23(c) gives to the parties a greater degree of protection than do many private settlements. *The salutary effect of the rule would be seriously impaired if dissatisfied parties could revive compromised claims against parties whom the settlement expressly covered.*

Stella, 218 F.2d at 64 (emphasis added).[16]

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15. *See, e.g., Grimes v. Vitalink Communications Corp.*, 17 F.3d 1553 (3d Cir. 1994); *Zimmer Paper Prods. Inc. v. Berger & Montague, P.C.*, 758 F.2d 86 (3d Cir. 1985); *Laskey v. International Union, United Auto., Aerospace & Agric. Implement Workers' of Am. (UAW)*, 638 F.2d 954 (6th Cir. 1981); *Stella v. Kaiser*, 218 F.2d 64, 67 (2d Cir. 1954); *Valerio*, 80 F.R.D. at 656; *Maldonado*, 573 F. Supp. at 686; *Bernstein v. Mediobanca Banca di Credito Finanziario-Societa Per Azioni*, 78 F.R.D. 1, 4-5 (S.D.N.Y. 1978); *Berman v. Thomson*, 403 F. Supp. 695, 700 (N.D. Ill. 1975).

16. *Stella* was decided before Rule 23.1 was adopted. At that time, Rule 23 governed class actions and derivative actions. Rule 23(c) established the procedures for settling such actions. *See* Text of Rules of Civil Procedure, 1 F.R.D. XCIII-XCIV (1941).

The Court of Appeals' decision is directly at odds with *Stella*. Here, the parties whom the *Shields* settlement and judgment covered have been again sued, along with others. Respondent seeks to recover the very same damages based on the identical facts at issue in the *Shields* action. While respondent claims that this action involves alleged malfeasance concerning the settlement of the *Shields* action, to prove that claim, respondent must first establish that the claims asserted in the *Shields* action were meritorious and prove the amount of damages allegedly caused to ICA based on the conduct at issue in the *Shields* action. In other words, to prove his alleged claims, respondent must relitigate every issue resolved by the *Shields* judgment. Instead of giving the parties to a judicially-approved derivative action settlement more protection than a private settlement, as required by *Stella*, the Court of Appeals' decision gives them none at all.

In *Grimes*, the Third Circuit expained why giving broad preclusive effect to settlements of corporate representative litigation is not only necessary, but also justified:

> When the underlying legal dispute is a class action, as is the present case, then the court has more than a ministerial duty to enter the negotiated settlement and release as a judgment. In this circumstance, the court has an elevated duty to ensure that the settlement is fair and adequate to all plaintiff class members, not just the named representatives who negotiated its substantive terms.

Grimes, 17 F.3d at 1557.

The Court of Appeals decision conflicts with *Grimes*. One of the Court of Appeals' reasons for not giving the *Shields*

judgment preclusive effect in this case is respondent's allegation that the settlement was the product of some lawyer's malpractice. *Durkin*, 92 F.3d at 1516.[17] The Court of Appeals, however, relied on cases that did not involve settlements approved under the rigors of Rule 23 or 23.1 and ignored cases, such as *Grimes* and *Stella*, which hold that class and derivative action settlements are unlike privately negotiated settlements because the court does not merely act as a referee, but as an active participant in the settlement process. In such actions, the court —not the parties — ultimately determines whether the case may settle.[18]

The Court of Appeals' decision conflicts with two recent Supreme Court decisions considering the preclusive effect of settlements of class and derivative litigation. In both cases, this Court reversed Ninth Circuit Court of Appeals decisions in which the Court of Appeals refused to give preclusive effect to judgments in representative litigation.

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17. As discussed in section III.A., below, this aspect of the Court of Appeals' decision is also directly at odds with Third and Sixth Circuit decisions which hold that the mere allegation of malpractice does not negate the court's findings made in connection with a hearing to approve a settlement of a representative action.

18. *See Weinberger v. Kendrick*, 698 F.2d 61, 69 n. 10 (2d Cir. 1982) ("[T]he judge should not regard himself as an umpire in typical adversary litigation."). Pursuant to Rule 23.1, *the court*, not the parties, determines whether a derivative action settlement "fairly and adequately serves the interests of the corporation on whose behalf the derivative action was instituted." *Mathes v. Roberts*, 85 F.R.D. 710, 713 (S.D.N.Y. 1980) (citations omitted); *see also Norman v. McKee*, 431 F.2d 769, 774 (9th Cir. 1970), *cert. denied*, 401 U.S. 912 (1971) (The district court acts "as guardian of the absent parties and the corporate fund as a whole."). Under Delaware law — which respondent concedes is controlling — the court "is called upon to exercise *its own business judgment*" in determining whether to approve a derivative action settlement. *Neponsit Investment Co. v. Abramson*, 405 A.2d 97, 100 (Del. 1979) (emphasis added).

In *Matsushita Electric Industrial Co. v. Epstein*, __ U.S. __, 116 S. Ct. 873 (1996), *rev'g Epstein v. MCA, Inc.*, 50 F.3d 644 (9th Cir. 1995), the Court held that full faith and credit demanded that the federal court respect a Delaware judgment approving a class action settlement even though (a) the settlement released claims within the exclusive jurisdiction of the federal courts and (b) the state court in approving the settlement noted: " 'the settling parties had previously proposed a patently inadequate settlement,' and . . . that 'suspicions [of collusion] abound.' " *Id.* at 1996 U.S. LEXIS at *45 (Ginsburg, J., concurring in part and dissenting in part).

Here, the rendering federal court had clear jurisdiction over the settled claims and there was no hint of collusion. Indeed, the *Shields* court was directly involved with the settlement negotiations and found the settlement was *not* collusive. (CR 463 at 87, 1 ER 211.) Thus, the foundation for applying issue preclusion in this case is more solid than in *Matsushita*.

In *Ticor Title Insurance Co. v. Brown*, 511 U.S. 117, 114 S. Ct. 1359, 1361 (1994), the Court observed that the "law of res judicata" prevented absent class members from collaterally attacking a class action settlement, even where the class was improperly certified in the prior action. In this case, there is no dispute that the *Shields* court properly found that the action could proceed as a derivative action on ICA's behalf. If principles of preclusion apply even where a class has been improperly certified, they certainly should apply here to bar respondent's collateral attack.

The conflict among the circuits requires immediate clarification by the Supreme Court. The Ninth Circuit's refusal to grant preclusive effect to the *Shields* judgment joins an Eleventh Circuit decision entered one month earlier, *Diaz v. Sheppard*, 85 F.3d 1502 (11th Cir. 1996). In *Diaz*, the Eleventh

Circuit allowed a collateral attack on a class action settlement approved under Rule 23 to proceed in a state court legal malpractice action.[19] As a result of the Court of Appeals' decision here and *Diaz*, Judge Easterbrook recently opined:

> Two recent decisions of other circuits — *Durkin v. Shea & Gould*, 92 F.3d 1510 (9th Cir. 1996), and *Diaz v. Sheppard*, 85 F.3d 1502 (11th Cir. 1996) — hold that a class may prosecute a malpractice action against its attorneys even after a settlement has been approved in a fairness hearing.

Kamilewicz v. Bank of Boston Corp., 100 F.3d 1348, 1353 (7th Cir. 1996) (Easterbrook, J., dissenting).

The clear conflict among the circuits that now exists calls for intervention by this Court by granting certiorari under Supreme Court Rule 10(a).

III. THE COURT OF APPEALS' REASONS FOR NOT APPLYING ISSUE PRECLUSION ARE ERRONEOUS AND CONFLICT WITH OTHER FEDERAL DECISIONS.

The Court of Appeals gave three reasons for not applying issue preclusion: (1) the issues were not "substantially identical;" (2) respondent was not given a "full and fair opportunity to litigate" the settlement's fairness in the *Shields* action; and (3) "special circumstances" exist that prevent the application of

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19. In the dissenting opinion, Judge Logan explained that before the underlying case could be settled, the district court was required under Rule 23 to determine the adequacy of counsel and that determination as matter of law, would bar a subsequent legal malpractice claim. *Diaz*, 85 F.3d at 1506-8 (Logan, J., dissenting).

issue preclusion.[20] Each of these reasons is legally flawed and conflicts with other federal authorities.

A. The Court Of Appeals Decision Conflicts With Other Federal Decisions Holding That Issue Preclusion May Apply Even When The Theory Of Relief Differs From The Theory Of Relief Brought In The Prior Action.

Shea & Gould contends that since the *Shields* court conclusively determined the settlement was fair, reasonable and adequate to ICA, respondent cannot establish the essential element of damages in this case.[21] The Court of Appeals, however, refused to apply issue preclusion because the legal theory of relief asserted in this case is professional negligence, which was not asserted in the *Shields* litigation. *Durkin*, 92 F.3d at 1519. The differences in legal theories of relief advanced, however, are not dispositive.[22]

20. Issue preclusion applies when (1) the party against whom the estoppel is asserted was a party to or in privity with a party in the first action; (2) the issue decided in the prior adjudication is substantially identical to the issue in the subsequent action; and (3) there was a final judgment on the merits. *Pension Trust Fund For Operating Eng'rs v. Triple A Mach. Shop, Inc.*, 942 F.2d 1457, 1462 (9th Cir. 1991). Issue preclusion, however, does not apply if the party against whom preclusion is sought or that party's privy did not have a full and fair opportunity to litigate. *See Montana v. United States*, 440 U.S. 147, 164 n. 11 (1979).

21. Under California law as elsewhere, the existence of damages is an essential element of a legal malpractice claim. *See Sukoff v. Lemkin*, 202 Cal. App. 3d 740, 744 (1988). If a plaintiff cannot establish that but for the alleged malpractice, the plaintiff would have received a greater amount from the prior litigation, the malpractice claim fails as a matter of law. *Id.* at 748, 750-51.

22. As its strongest authority for the notion that fairness of a settlement is a "different issue" in a subsequent malpractice case, the Court of Appeals cited New Jersey divorce case offered by respondent that has nothing to do with federal representative litigation under Rule 23.1. *Ziegelheim v. Appolo*, 607 A.2d 1293, 1305 (N.J. 1992).

Issue preclusion applies if the issues are substantially identical. *Montana*, 440 U.S. at 155. That the issues in the prior action and the subsequent action are not *framed* identically or stated in the same language is irrelevant. *Id.*; *see also Collard v. Incorporated Village of Flower Hill*, 604 F. Supp. 1318, 1323 (E.D.N.Y. 1984) ("The application of the doctrine of *res judicata* or collateral estoppel does not require a showing that the issue in the prior action was framed in the same language or that the same theory of liability was charged as in the subsequent action. The basis of establishing an identity of issues is broader and more practical."), *aff'd*, 759 F.2d 205 (2d Cir.), *cert. denied*, 474 U.S. 827 (1985).

The Court of Appeals' decision is in direct conflict with decisions of the Sixth and Third Circuits, *Laskey* and *Zimmer*. In *Laskey*, members of a plaintiff class sued the attorneys for their class for malpractice after the court approved the settlement of a class action. *Laskey*, 638 F.2d at 955. As here, the *Laskey* plaintiffs claimed that the attorneys "did not adequately represent them in their prior lawsuit . . . and committed legal malpractice" by allowing the class to enter an inadequate settlement. *Id.* In *Laskey*, however, the district court dismissed the plaintiffs' case on summary judgment, holding that because the court in the prior action had necessarily determined before accepting the settlement that the class had been adequately represented, the plaintiffs were collaterally estopped from asserting their malpractice claim. *Id.*

On appeal, the Sixth Circuit affirmed the district court's decision. The court explained: "When the same parties litigate a different cause of action, they are bound by a prior determination of any matter actually litigated before between the parties." *Id.* at 956. The court emphasized that in the underlying class action: "The District Court below found as a matter of fact that the class had been adequately represented by

the class representatives and that legal counsel was adequate." *Id.* at 957. The court then held:

> Since appellants had the opportunity to object to the legal representation at the prior settlement hearing and since a finding that the class was adequately represented is necessary for finding the settlement was fair and reasonable, which in turn was essential to approving the settlement, appellants are collaterally estopped from now asserting that the legal representation was not adequate and that the UAW committed legal malpractice.

Id. (citation omitted).

Similarly, in *Zimmer Paper Products*, the Third Circuit Court of Appeals held that findings in a prior class action barred a class member from suing the attorneys for the class in a subsequent malpractice action. There, the plaintiff alleged that class counsel was liable for negligence and breach of fiduciary duty because the plaintiff did not receive the notice of settlement and, as a result, the plaintiff failed to submit a timely claim against the settlement fund. *Zimmer Paper Products*, 758 F.2d at 88. The district court granted the attorneys' summary judgment motion and the Third Circuit affirmed, explaining:

> Before approving any distribution of settlement proceeds to class members, the district court undoubtedly considered such factors. If it were dissatisfied it would have ordered further notice procedures. . . . Once a court, whose discretionary order is presumptively valid, has properly sanctioned such a notice procedure . . . a complaining

> party faces a standard at least as high as abuse of discretion in seeking to show malpractice by counsel who followed the court's order.

Id. at 93.[23]

As shown by *Laskey*, *Zimmer Paper Products*, and other cases, the differences in the theories of relief asserted in the *Shields* action and this case do not prevent the application of issue preclusion. The Court of Appeals' decision is erroneous and clearly conflicts with other circuits on this issue.

B. The Court Of Appeals Failed To Recognize That The Very Purpose Of Rule 23.1's Procedures Is To Ensure A Full And Fair Opportunity To Litigate.

The Court of Appeals also held that respondent's mere allegation of malpractice somehow deprived ICA of a full and

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23. In *Bernstein*, the court held that a state court derivative action settlement barred the relitigation of factual findings made in hearings to determine whether the settlement was fair, adequate and reasonable to the corporation for which the derivative action was brought. *Bernstein*, 78 F.R.D. at 2-3. The plaintiffs argued that issue preclusion could not apply because the state court action only involved state law theories of relief, not the federal securities claims asserted by them. The court disagreed, holding the findings made by the state court in the prior action "are inconsistent with plaintiff's claims in this action and thus preclude the maintenance of this action on the ground of collateral estoppel." *Id.* at 4-5. Similarly, in *Goldman v. Northrop Corp.*, the Court of Appeals held the plaintiffs in a derivitative action were barred from asserting claims based on a prior derivative action settlement, even though the particular claims asserted were not made in the prior action. *Goldman v. Northrop Corp.*, 603 F.2d 106, 109 (9th Cir. 1979).

fair opportunity to litigate. *Durkin*, 92 F.3d at 1516-17. As shown above, however, the Third and Sixth Circuits have not allowed a mere allegation of malpractice to negate findings made in the settlement approval process in representative litigation and have held that such findings barred subsequent malpractice claims. *Zimmer Paper Products*, 758 F.2d at 93; *Laskey*, 638 F.2d at 956. Moreover, the Court of Appeals' second rationale for affirming the district court misses the entire purpose of Rule 23.1 (and its companion, Rule 23).

Before an action is allowed to proceed derivatively on behalf of a corporation, Rule 23.1 requires the court find that the shareholder plaintiffs fairly and adequately represent the interests of the corporation and other shareholders. Fed. R. Civ. P. 23.1.

> The importance of determining adequate representation cannot be understated. The rule that the representation must fairly and adequately represent the class is one of constitutional magnitude. This is due to the *binding effect* of derivative and class actions on absent class members. . . .

Guenther v. Pacific Telecom, Inc., 123 F.R.D. 341, 344 (D. Or. 1987) (emphasis added).

There is no dispute that the *Shields* court found that the Shareholder Plaintiffs were adequate derivative case fiduciaries and that the action should proceed as a derivative action on ICA's behalf. This finding had a critical impact on the *Shields* action — it placed control and enforcement of the derivative claims firmly in the hands of the Shareholder Plaintiffs.[24] As a result,

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24. *See, e.g., Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 95 (1991) (Cont'd)

Shea & Gould, as counsel retained by the defendants in the derivative action to represent ICA, could not enforce the claims asserted in the *Shields* action for ICA.[25]

The Court of Appeals also failed to recognize that the derivative claims asserted in *Shields* were allowed to be compromised and released only because the *Shields* court, not the parties to the action, determined that the settlement was fair, adequate and reasonable to ICA.

A settlement tested by the Rule 23.1 procedures does not merely represent a contractual arrangement between the named parties. *See In re Gottheiner*, 703 F.2d 1136, 1140 (9th Cir. 1983); *Stella*, 218 F.2d at 67. Before a derivative action can be settled, pursuant to Rule 23.1, *the court* determines whether the settlement "fairly and adequately serves the interests of the corporation on whose behalf the derivative action was instituted."

(Cont'd)

("The derivative form of action permits an individual shareholder to bring 'suit to enforce a *corporate* cause of action against officers, directors, and third parties.' . . . Devised as a suit in equity, the purpose of the derivative action was to place in the hands of the individual shareholder a means to protect the interests of the corporation . . .") (emphasis in original and citation omitted); *Breswick & Co.*, 135 F. Supp. at 403 ("[T]he 'real party in interest' in all of the pending derivative actions is the corporation itself but the real parties *in litigation* are those stockholders who are undertaking the trouble and expense of establishing the rights of the corporation." (emphasis in original).

25. While the Court of Appeals recognized an issue as to whether Shea & Gould had a duty to represent ICA's interest as plaintiff, it wrongly concluded that it could not rule upon the issues because the issue somehow involved a question of fact. *Durkin*, 92 F.3d at 1517. Under California law, however, the existence of a duty — as opposed to breach of duty — is a question of law. *Scott v. Chevron U.S.A.*, 5 Cal. App. 4th 510, 516 (1992); *Hegyes v. Unijan Enters., Inc.*, 234 Cal. App. 3d 1103, 1111 (1991).

Mathes, 85 F.R.D. at 713; *accord Zimmerman v. Bell*, 800 F.2d 386, 391 (4th Cir. 1986); *Oracle*, 829 F.Supp. at 1186.[26] As noted above, in this process, the court does not act merely as a referee, but exercises its independent judgment to determine fairness.[27] To reach that conclusion, the court is required to determine that there was no fraud or collusion in arriving at the settlement agreement and that the agreement was reached through arm's length negotiations. *Zimmerman*, 800 F.2d at 391; *Maher*, 714 F.2d at 455. "The matter is one for the discretion of the district court. The exercise of that discretion is presumptively correct, subject to reversal only where abused." *Zimmerman*, 800 F.2d at 391. The result of this process is an adjudication that is final and binding on all parties interested in the derivative action, including the corporation for which the action is brought. *See Goldman*, 603 F.2d at 109.

Here, respondent does not dispute that the *Shields* court fully complied with Rule 23.1. By following these procedures, the *Shields* court assured ICA a full and fair opportunity to litigate. Moreover, these procedures required the *Shields* court to exercise its independent judgment to determine whether the settlement was fair to ICA. The Court of Appeals' rationale that ICA may not have been given a full and fair opportunity to litigate fails to recognize a basic purpose of Rule 23.1.

The Court of Appeals' refusal to give the *Shields* judgment preclusive effect on this basis conflicts with a previous decision

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26. Another reason for the court's active role in evaluating derivative action settlements is the natural affinity between the corporate managers who are defendants in the derivative cases and the lawyers they hire to represent the corporation. *See Oracle*, 829 F. Supp. at 1188-89; *Breswick*, 135 F. Supp. at 403.

27. *See supra*, note 18.

of a highly respected district court judge which was adopted by reference in it entirety by the Court of Appeals in *Valerio v. Boise Cascade*. There, the plaintiffs sought (i) to vacate a judgment approving a class action settlement and (ii) damages against the attorneys who represented the class. The plaintiffs argued the attorneys breached their fiduciary duties to the class because they fraudulently or negligently misrepresented and concealed material facts and thereby induced class members to enter the settlement.

The court rejected plaintiff's arguments, holding the very purpose of Rule 23's procedural safeguards is to mitigate the sometimes harsh consequences of *res judicata* in representative actions. *Valerio*, 80 F.R.D. at 648. The court explained that where Rule 23 requirements are met, there are few instances in which a class action defendant should not receive the full benefit of *res judicata* and that one might well argue for a more *liberal* application of *res judicata* upon a settlement where the requirement of court approval prevents the overreaching that might otherwise exist. *Id.* at 648-49. Because of the overriding public interest in settling litigation, which is particularly true in class action suits, the court refused to restrict *res judicata* for representative actions. *Id.* at 649. Finally, the court rejected the contention that settlements should not be given preclusive effect, pointing out that the appellate courts have not hesitated to apply collateral estoppel based on a prior securities action settlements. *Id.* at 656.

Additionally, the Court of Appeals reasoned in the case below that issue preclusion would not apply because the *Shields* court's determination of adequacy of representation was somehow limited to the representation of shareholders and not "the full corporate interests of ICA," particularly the interests of ICA's creditors. *Durkin*, 92 F.3d at 1516-17.[28] This ruling is

28. Interestingly, the only "authority" cited by the Court of Appeals (Cont'd)

contrary to the legion of authorities that derivative actions involve litigation of *corporate* rights, not shareholder rights. *See, e.g., Cramer v. General Tel. & Elecs. Corp.*, 582 F.2d 259, 268 (3d Cir. 1978) ("Although a derivative action is brought by a single shareholder, the named plaintiff represents both the corporation itself and the entire class of stockholders."); *Kaplan v. Bennett*, 465 F.Supp. 555, 560 (S.D.N.Y. 1979) ("A derivative action represents prosecution of a claim belonging not to the individual shareholder but to the corporation on whose behalf suit is brought.") (Citations omitted).

The Court of Appeals' decision also conflicts with its own decision in the companion case of *In re Imperial Corp. of America*, 92 F.3d 1503 (9th Cir. 1996). There, the Court of Appeals held that res judicata barred the attempt of the FDIC, as successor-in-interest to ICA's former subsidiary, Imperial Savings, to relitigate the claims resolved by the *Shields* judgment — the very same judgment that the Court of Appeals refused to accord preclusive effect in this case. *Id.* at 1510. The court explained that the judgment, which was binding on ICA, was binding on its subsidiary, Imperial Savings, under the concept of "virtual representation." *Id.* at 1507-8. Claim preclusion, like issue preclusion, is also conditioned on a "full and fair opportunity to litigate" in the prior action. *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 481 n.22 (1981). Thus, in order to apply claim preclusion in the companion case, the Court of Appeals necessarily found there *was* a "full and fair opportunity to litigate" in the *Shields* action, which is contrary to its finding in this case.

(Cont'd)
for the proposition that creditors could relitigate issues resolved by a derivative action settlement is an argument barren of supporting authority made in an article authored by a member of one of the law firms representing respondent during the course of this action. *See Durkin*, 92 F.3d at 1517 n. 14.

C. Special Circumstances Did Not Prevent The Court Of Appeals From Applying Issue Preclusion.

The last reason given by the Court of Appeals for refusing to give the *Shields* judgment preclusive effect in this case is its suggestion that "special circumstances" existed to "warrant an exception to the normal rules of preclusion." *Durkin*, 92 F.3d at 1518. The "special circumstances" referred to by the court are: (1) respondent's contention that the prior settlement was the product of collusion or a fraud on the court and (2) Shea & Gould's alleged malpractice. Both of these "special circumstances" are contradicted by the specific findings in the *Shields* judgment.

Before a derivative action can be settled, the district court must determine that there was no fraud or collusion in arriving at the settlement agreement and that the agreement was reached through arm's length negotiations. *Zimmerman*, 800 F.2d at 391; *Maher*, 714 F.2d at 455. The *Shields* court found that settlement "is the product of good faith arm's length negotiations by the parties thereto." (CR 463 at 87, 1 ER 211.) Therefore, the Court of Appeals' concern about collusion in the settlement of the *Shields* action represents yet another assault on the conclusive findings made by the *Shields* court. In fact, respondent has never pleaded that the *Shield* judgment is the product of a fraud on the court under Rule 60(b) or otherwise.[29]

Further, as discussed above, the findings that ICA was adequately represented *by the Shareholder Plaintiffs*, and that

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29. Likewise, earlier in the case below, respondent represented: "Nowhere in the First Amended Complaint is there an allegation that the Shea Defendants conspired with anyone . . ." (CR 159 at p. 16.)

the *Shields* action could proceed as a derivative action, established conclusively who controlled the enforcement of the derivative claims. Thus, the *Shields* judgment itself negates the existence of the only alleged "special circumstances" relied upon by the Court of Appeals.

CONCLUSION

For the reasons set forth above, petitioners Shea & Gould and Sheldon Camhy respectfully request that their petition for writ of certiorari be granted.

Respectfully submitted,

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APPENDIX A — DISTRICT COURT'S ORDER DENYING SHEA DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND GRANTING IN PART AND DENYING IN PART PLANTIFF'S MOTION FOR LEAVE TO FILE AMENDED COMPLAINT FILED JULY 12, 1994

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case Number 92-1003-IEG (LSP)

In re

IMPERIAL CORPORATION OF AMERICA, a Delaware Corporation,

Debtor.

Case No. 90-01585-A11 Southern District of California

RONALD L. DURKIN, TRUSTEE OF THE BENCHMARK IRREVOCABLE TRUST,

Plaintiff,

v.

RODNEY B. SHIELDS, THREE BRIDGES INVESTMENT GROUP, MAX GRILL; WILLIAM STEINER; SONEM PARTNERS; MILBERG, WEISS, BERSHAD, SPECTHRIE & LERACH; WILLIAM S. LERACH; KEITH F. PARK; HELEN J. HODGES; ALAN SCHULMAN; GREENFIELD & CHIMICLES; RICHARD D. GREENFIELD; FRANCIS J. FIRANA; KEVIN P. RODDY; BARRACK, RODOS & BACINE; LEONARD BARRACK; EDWARD M. GERGOSIAN; DOUGLAS J. CAMPION; GERALD J. RODOS; BERGER & MONTAGUE, P.C.; SHERRIE R.

SAVETT; DAVID RICHAN; STULL, STULL & BRODY; JULES BRODY; GOODKIND, LABATON & RUDOFF; LAWRENCE SUCHAROW; CLEMENS, GLASSMAN & CLEMENS; MICHAEL S. GLASSMAN; RABIN & SIROTA; HOWARD SIROTA; SCHIFFRIN & CRAIG; RICHARD SCHIFFRIN; KENNETH J. THYGERSON; KEVIN E. VILLANI; ROCCO J. FABIANO; STEPHEN M. WRIGHT; ROBERT E. ALSCHULER, RICHARD A. ARCHER; GARY M. CYPRES; VICTOR N. GOULET; STUART I. GREENBAUM; LYMAN C. HAMILTON, JR.; JOHN W. KENNEY; ALLAN R. TESSLER; CNA/ AMERICAN CASUALTY COMPANY OF READING PENNSYLVANIA; and RELIANCE INSURANCE COMPANY,

Defendants.

IMPERIAL CORPORATION OF AMERICA, a Delaware corporation,

Plaintiff,

v.

MILBERG, WEISS, BERSHAD, SPECTHRIE & LERACH, a California partnership; GREENFIELD & CHIMICLES; BARRACK, RODOS & BACINE; CLEMENS, GLASSMAN AND CLEMENS; BERGER & MONTAGUE, P.C.; SIROTA & SIROTA; STULL, STULL & BRODY; GOODKIND, LABATON & RUDOFF; SCHIFFRIN & CRAIG, LTD.,

Defendants.

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ORDER DENYING SHEA DEFENDANTS' MOTION FOR SUMMARY JUDGMENT AND GRANTING IN PART AND DENYING IN PART PLAINTIFF'S MOTION FOR LEAVE TO FILE AMENDED COMPLAINT [DOC. ## 457 and 460]

The following motions came on regularly for hearing on July 1, 1994, at 9:00 a.m. in Courtroom 11 of the above-entitled court, the Honorable Irma E. Gonzalez, presiding: 1) the Shea Defendants' (Shea & Gould and Sheldon Camhy) Motion for Summary Judgment or Partial Summary Judgment with regard to Claim 20 of the Second Amended Complaint; and 2) Plaintiff Ronald L. Durkin's Motion for Leave to File a Third Amended Complaint and to Consolidate this Action with *Durkin v. Baker & McKenzie*, Case No. 94-823.

Michael H. Weiss of the law firm of Weiss, Scolney & Spees and Francis J. Burke, Jr. of the law firm of Steptoe & Johnson appeared on behalf of plaintiff Ronald L. Durkin. Jay D. Hanson and Robert W. Brownlie of the law firm of Gray, Cary, Ames & Frye appeared on behalf of the Shea Defendants. James P. Hill and Donald G. Rez of the law firm of Sullivan, Hill, Lewin & Markham appeared on behalf of the Milberg, Weiss Defendants (Milberg, Weiss, Bershad, Specthrie & Lerach, William S. Lerach, Keith F. Park, Helen J. Hodges, Alan Schulman, Greenfield & Chimicles, Richard D. Greenfield, Francis J. Farina, Kevin P. Roddy, Barrack, Rodos & Bacine, Leonard Barrack, Edward M. Gergosian, Douglas J. Campion, Gerald J. Rodos, Goodkind, Labaton, Rudoff & Sucharow, Lawrence Sucharow, Glassman & Clemens, Michael S. Glassman, Rabin & Sirota, Howard Sirota, Schiffrin & Craig, Richard Schiffrin, Rodney B. Shield, Three Bridges Investment Group, William Steiner, Sonem Partners and Max Grill).

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L. Allan Songstad, Jr. and Janet E. Humphrey of the law firm of Meserve, Mumper & Hughes appeared on behalf of the Resolution Trust Corporation. Charles A. Bird of the law firm of Luce, Forward, Hamilton & Scripps appeared on behalf of the Director Defendants (Robert E. Alshuler, Richard A. Archer, Gary M. Cypres, Victor N. Goulet, Stuart I. Greenbaum, Lyman C. Hamilton, Jr., John W. Kenney, and Allan R. Tessler).

I. ***Shea Defendants' Motion for Summary Judgment***

The Shea Defendants move for summary judgment as to Claim 20 of the Second Amended Complaint ("SAC"), the sole claim presently asserted against them. Alternatively, the Shea Defendants move for partial summary judgment on the issues of: 1) whether they breached any professional duty owed to Imperial Corporation of America ("ICA") by failing to advise ICA's Board of Directors to establish an independent and disinterested special litigation committee ("SLC"); and 2) whether the settlements in the underlying derivative actions were fair, adequate and reasonable to ICA. In addition, the Shea Defendants filed a request for judicial notice of the Final Judgment of Dismissal in the underlying *Shields* action, which request is **GRANTED** pursuant to Rule 201 of the Federal Rules of Evidence.

The Shea Defendants ask this Court to rule, as a matter of law, that they had no professional obligation to advise ICA to establish an independent SLC. However, whether the Shea Defendants breached any duty to advise ICA to establish an independent SLC is not dispositive of the plaintiff's claims against them for legal malpractice and breach of fiduciary duty which, in any case, concern questions of fact that must be resolved by the trier of fact. *See Lipscomb v. Krause*, 87

Cal.App.3d 970, 975-76 (1978); *Kirsch v. Duryea*, 21 Cal.3d 303, 311 (1978) (expert testimony required to establish negligence of attorney).

Moreover, as plaintiff correctly points out, in an order dated October 1, 1993, this Court ruled that the Director Defendant's motion to dismiss on the ground that they had no duty to appoint an independent SLC was premature. (Order at pp. 18-19). Discovery has only recently begun and plaintiff has not yet had the opportunity to receive and review the relevant discovery from the Shea Defendants and others. Neither has any expert witness discovery yet been taken on this issue. Accordingly, the Court declines to rule as a matter of law that the Shea Defendants did not commit legal malpractice or breach any fiduciary duty by failing to advise ICA to establish an independent SLC. The motion for summary judgment on this ground therefore is **DENIED** without prejudice to renew at the close of discovery.

The Shea Defendants also argue that plaintiff is barred by the doctrines of claim and issue preclusion from litigating the issues of whether the *Shields* settlement was fair, reasonable, and adequate as to ICA or whether ICA was adequately represented by the derivative shareholder plaintiffs. They contend that these issues were conclusively resolved when Magistrate Judge McCue approved the *Shields* settlement on February 22, 1990, and that because these issues are crucial to the claims asserted against them in this action, summary judgment must be granted in their favor.

However, application of either claim or issue preclusion requires that the party against whom the defense is asserted have had a "full and fair opportunity to litigate" the claim or issue in the earlier proceeding. *Kremer v. Chemical Constr. Corp.*, 456

U.S. 461, 480-81 & n.22 (1982) (claim and issue preclusion are subject to the same "requirement of a full and fair opportunity to litigate."). As this Court previously held, plaintiff was not provided with a full and fair opportunity to litigate the adequacy of the settlement. *See* February 24, 1993 Order at p. 7 ("February 24th Order"). *See also* Transcript of Proceedings Before Hon. Judith S. Keep Dated August 17, 1992 at pp. 23-24 (rejecting argument that plaintiff's claims are barred by collateral estoppel).

Moreover, wholly apart from this Court's February 24th Order, the prior adjudication of the adequacy of a settlement does not collaterally estop a legal malpractice claim challenging the conduct of a party's lawyer during the prior action because the essence of such a claim is that the Court's decision approving the settlement would have been different absent the negligence of the party's attorney. *See Ruffalo v. Patterson*, 234 Cal.App.3d 341, 344 (1991).

Similarly, plaintiff is not precluded from asserting his claim that ICA was not adequately represented by the Shea Defendants because that issue was not actually litigated in the underlying actions. Indeed, a claim that the Shea Defendants committed legal malpractice in connection with their role in the *Shields* litigation and settlement did not even accrue until the settlement became final and, in any case, for all practical purposes could not have been asserted until after plaintiff was appointed representative of the estate. *See, e.g., Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1518 (9th Cir. 1985). Moreover, any finding by Judge McCue as to the adequacy of the derivative shareholder plaintiffs' representation of ICA is not dispositive of the issue of whether the Shea Defendants breached any duty owed to ICA.

Finally, as indicated earlier, whether the Shea defendants breached any duty to ICA in connection with the *Shields* litigation and settlement is a factual issue that can only be properly resolved once the relevant discovery, which has barely begun, can be reviewed.

Accordingly, pursuant to the foregoing discussion, the Shea Defendants' motion for summary judgment or, alternatively, for partial summary judgment is **DENIED**.

II. *Durkin's Motion for Leave to File Amended Complaint and to Consolidate*

Plaintiff Ronald Durkin moves pursuant to Rules 15(a) and 42(a) of the Federal Rules of Civil Procedure for leave to file a Third Amended Complaint ("TAC") and to consolidate the present action with *Durkin v. Baker & McKenzie*, Case No. 94-823. The Proposed TAC joins as additional defendants the individual partners of the law firm of Shea & Gould, which was formerly counsel to ICA and which, together with Sheldon Camhy, already is defending this action. The TAC also adds allegations arising out of the dismissal with prejudice of, and release of claims against, Drexel Burnham Lambert ("Drexel") and Michael Milken as part of the settlement of the Underlying Actions; and the failure to file a timely claim against the fund established by the U.S. Bankruptcy Court for the Southern District of New York to pay claims against Chapter 6 debtor Drexel (the "Drexel Claim Fund").

In addition, the TAC supplements the Ninth, Tenth, and Twelfth Claims, and seeks to "realign and clarify" the Thirteenth and Fourteenth Claims against the derivative plaintiffs and the derivative plaintiffs' lawyers, purportedly "to conform the

allegations to prior rulings of the Court." Finally, the TAC consolidates this action with *Durkin v. Baker & McKenzie,* the reference of which this Court recently withdrew from the Bankruptcy Court on joint motion of the parties.

Absent bad faith by the plaintiff, prejudice to the defendants, undue delay, or futility of the amendment, leave to amend should be freely granted. *DCD Programs, Ltd. v. Leighton*, 833 F.2d 183, 186 (9th Cir. 1987); *see* Fed. R. Civ. P. 15(a).

The Director Defendants and the Milberg Weiss Defendants[1] oppose plaintiff's motion primarily on the ground that the proposed amendment is futile. Also, plaintiff has filed an opposition to the Milberg Weiss Defendants' Supplemental Request for Judicial Notice on the grounds that it not only is untimely but also is a thinly-veiled attempt to file a surreply brief without prior authorization from the Court. The Court agrees that this supplemental request is improper and therefore has not considered it. However, the Milberg Weiss Defendants' initial request for judicial notice is proper and is hereby **GRANTED** pursuant to Rule 201 of the Federal Rules of Evidence.

Plaintiff seeks to join the remaining Shea & Gould partners as individual defendants alongside Sheldon Camhy and the partnership in dissolution to ensure that plaintiff will be able to recover against the partners' personal property on any judgment based on the Shea Defendants' alleged negligence. The claims

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1. The Milberg, Weiss Defendants' opposition papers have been separately joined in by defendants Barrack, Rodos & Bacine, Leonard Barrack, Douglas J. Campion, Edward M. Gergosian and Gerald J. Rodos; defendants Stull, Stull & Brody and Jules Brody; and defendants Berger & Montague, P.C., David Richan, and Sherrie R. Savett.

against these new individual defendants arise out of the same facts and raise the same legal issues as the claims against Shea & Gould and Sheldon Camhy. The added partners' alleged joint and several liability is based on their status as partners rather than on any additional, personal conduct. *See* Cal. Corp. Code §§ 15013, 15015(a) (all partners and partnerships are jointly and severally liable for wrongful acts and omission of partners).

Plaintiff explains that he is now seeking leave to add these new defendants because he learned only two months ago that Shea & Gould might not be able to respond to the relief requested in the SAC and that the firm had announced its intention to dissolve. Plaintiff further contends that the claims against these new defendants are valid because they have been upheld against two prior attempts by the Shea Defendants to dismiss them (*see* Orders Dated October 1, 1993 and December 1, 1993), the claims are not barred by the statute of limitations, and this Court can exercise personal jurisdiction over these defendants.

The Shea Defendants argue that the proposed TAC is futile because it seeks to add defendants over whom personal jurisdiction is lacking, the claims are barred by the statute of limitations, and, in any case, the proposed causes of action fail to state a claim upon which relief can be granted. The Shea Defendants' reliance on *Sher v. Johnson*, 911 F.2d 1357 (9th Cir. 1990) in support of their argument that personal jurisdiction cannot be asserted over the new defendants, however, is misplaced. In *Sher*, the Ninth Circuit held that personal jurisdiction under California's long-arm statute could not be asserted over nonresident partners of a Florida partnership based on a single partner's contacts with California. *Id.* at 1366.

In contrast to *Sher*, plaintiff here seeks to assert personal

jurisdiction over the Shea partners based on Shea's having an office in Los Angeles, California and Shea's participation in litigation in this state. There is substantial authority that where the partnership has an office in the forum state or does substantial work for a client in the state, the partners are subject to personal jurisdiction without regard to their personal contacts. In any case, the Shea Defendants have failed to prove that plaintiff will be unable to establish that the newly added defendants have contacts with California sufficient to justify the exercise of personal jurisdiction over them. Accordingly, the Court cannot at this stage find as a matter of law that the amendment would be futile on this ground.

The Court further finds unavailing the Shea Defendants' arguments concerning the statute of limitations. The claims arising out of the *Shields* settlement are not time-barred because they arise out of the same conduct, transaction or occurrence set forth in plaintiff's already-existing claims against the Shea Defendants (Shea's advice to ICA) and thus "relate-back" to when those claims were first asserted. *See, e.g., Martell v. Trilogy, Ltd.*, 872 F.2d 322, 325-27 (9th Cir. 1989); *see* Rule 15(c)(2); *see also* 6A C. Wright, A. Miller & M. Kane, *Federal Practice & Procedure*, § 1498 (1990). The claims concerning the Drexel Claim Fund did not accrue until plaintiff suffered an adverse judgment which, in this case, was on April 28, 1994 when the bankruptcy court denied plaintiff's motion for leave to file a late claim on behalf of ICA. *See Laird v. Blacker*, 2 Cal.4th 606, 609, *cert. denied*, 113 S.Ct. 658 (1992). Accordingly, the Court cannot conclude at this stage that assertion of the foregoing claims would be futile because they are time-barred.

Finally, the proposed claims concerning notification to the

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D&O insurance carriers are the subject of two declaratory judgment actions presently pending in this Court which have not yet been resolved. These claims cannot be time-barred at this point because ICA has not yet suffered any "actual injury" and the claims thus have not yet accrued.

The Shea Defendants also argue that the proposed claims concerning their advice to ICA fail to state a valid claim for relief primarily for the reasons that this Court has already rejected as insufficient to warrant granting the Shea Defendants' previously discussed motion for summary judgment. Whether defendants in fact breached the applicable standard of care is certainly not an issue that can be resolved at this stage in connection with a motion for leave to file an amended complaint. Accordingly, the Shea Defendants' arguments that the proposed amendment would be futile as it relates to them are rejected.

The Milberg Weiss Defendants argue that plaintiff's proposed amendment of Claims 13 and 14 is futile because plaintiff seeks to reinstate claims that have already been dismissed by this Court. Claim 13 is entitled "Breach of Fiduciary Duty against the Derivative Plaintiffs with the Substantial Assistance and Encouragement or Aiding and Abetting by the Derivative Plaintiffs' Lawyers." This claim in essence asserts that the derivative plaintiffs, with the assistance of their attorneys, breached their fiduciary obligations "to ICA and its creditors". Claim 14 is entitled "Legal Malpractice; Breach of Fiduciary Duty — Derivative Plaintiffs' Lawyers" and asserts breach of a duty of care owed to ICA.

However, as the Milberg Weiss Defendants correctly point out, and as plaintiff appears to concede, in an order dated December 1, 1993, this Court held as a matter of law that a

claim for legal malpractice or breach of fiduciary duty owed to ICA by counsel for the class and derivative plaintiffs must be dismissed because counsel owed no duty to ICA or to Durkin. Thus, despite plaintiff's suggestion to the contrary based on earlier orders in this case, the December 1, 1993 order is the law of the case and is this Court's final word on this particular subject. Also, there is no valid basis for reasserting already dismissed claims for the sake of "preserving the record."

Accordingly, to the extent that plaintiff seeks leave to file an amended complaint reasserting previously dismissed claims against class or derivative plaintiffs' counsel based on an alleged duty owed to ICA or Durkin, the motion is **DENIED**. Thus, plaintiff's proposed Claim 14 is precluded in its entirety as are the aiding and abetting claims (and the related "de facto plaintiff" claims) against the class and derivative plaintiffs' counsel set forth in Claim 13. However, the Court finds that the Milberg Weiss Defendants' additional arguments concerning the alleged futility of the remainder of proposed Claim 13 are unconvincing. The Court therefore declines to hold as a matter of law that assertion of Claim 13 will be futile to the extent that it does not assert a claim, either directly or indirectly, against the class and derivative plaintiffs' counsel.

Pursuant to the foregoing discussion, apart from plaintiff's attempt to reassert previously-dismissed claims against the class and derivative plaintiffs' counsel, the Court finds that the proposed amendment is made in good faith, that plaintiff has not unduly delayed seeking leave to amend, that defendants have not demonstrated that they will be prejudiced by the amendment, and that the proposed amendment is not futile.

Accordingly, plaintiff's motion for leave to file an amended

complaint and to consolidate this action with *Durkin v. Baker & McKenzie* is **GRANTED IN PART AND DENIED IN PART.** Plaintiff shall have 30 days from the date of this order to file its proposed third amended complaint that has been modified in compliance with this Order.

IT IS SO ORDERED.

Dated: July 12, 1994

s/ Irma E. Gonzalez
IRMA E. GONZALEZ
United States District Judge

Copies distributed/mailed (see pages 14 through 18 attached hereto and incorporated herein by reference).

APPENDIX B — DISTRICT COURT'S ORDER GRANTING DEFENDANTS' MOTION TO CERTIFY DECISION FOR INTERLOCUTORY APPEAL FILED DECEMBER 8, 1994

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case Number 92-1003-IEG (LSP)

In re

IMPERIAL CORPORATION OF AMERICA, RELATED LITIGATION,

RONALD L. DURKIN, TRUSTEE OF THE BENCHMARK IRREVOCABLE TRUST,

Plaintiff,

v.

RODNEY V. SHIELDS, et al.,

Defendants.

KEVIN E. VILLANI,

Counterclaimant,

v.

RONALD L. DURKIN, TRUSTEE OF THE BENCHMARK IRREVOCABLE TRUST,

Counterdefendant.

Appendix B

KEVIN E. VILLANI,

Third-Party Plaintiff,

v.

THE RESOLUTION TRUST CORPORATION, in its Capacity as Receiver for IMPERIAL SAVINGS AND LOAN ASSOCIATION, and IMPERIAL CORPORATION OF AMERICA,

Third-Party Defendants.

ORDER GRANTING DEFENDANTS' MOTION TO CERTIFY DECISION FOR INTERLOCUTORY APPEAL [DOC. ## 572, 573]

Defendants Shea & Gould and Sheldon Camhy (collectively "Shea defendants") attempted to join in a motion brought in *RTC v. Alschuler,* Civ. No. 93-0992, and *RTC v. Greenbaum,* Civ. No. 93-1256 (collectively the "*RTC* Actions"), by certain Director defendants to certify decision for interlocutory appeal. However, because Shea defendants are not parties to those actions and their joinder raised slightly different issues from the motions then pending before the Court, this Court deemed the Shea defendants' "joinder" a separate motion.

Defendants Milberg, Weiss, Bershad, Hynes & Lerach; William S. Lerach; Keith F. Park; Helen J. Hodges; Alan Schulman; Greenfield & Chimicles; Richard D. Greenfield; Francis J. Farina; Kevin P. Roddy; Barrack, Rodos & Bacine; Leonard Barrack; Edward M. Gergosian; Douglas J. Campion; Gerald J. Rodos; Goodkind, Labaton, Rudoff & Sucharow;

Lawrence Sucharow; Classman and Clemens, A Professional Corporation; Michael S. Classman; Rabin & Sirota; Howard Sirota; Schiffrin & Craig; Richard Schiffrin; Rodney B. Shields; Three Bridges Investment Group; William Steiner; Sonem Partners; and Max Grill (collectively the "Former Actions Class and Derivative defendants"), recognizing that they could not formally join in the Director defendants' motions in the *RTC* Actions, filed a memorandum in support of Shea defendants motion; such memorandum will now be considered a joinder in Shea defendants' motion to certify.

This Court, having reviewed the memoranda in support of and opposition to Shea defendants' motion, including Former Actions Class and Derivative defendants' memorandum, and good cause appearing therefor, finds this matter suitable for decision without oral argument. *See* Local Rule 7.1(d)(1).

I

BACKGROUND

Plaintiff Ronald Durkin brought the instant action against numerous defendants for their alleged acts in the negotiation and settlement of certain class and derivative actions that were brought against Imperial Corporation of America ("ICA") and its officers and directors (*Shields v. Thygerson,* Civ2. No. 89-0126 or the "*Shields* litigation").[1] In his twentieth claim for

1. Numerous cross-complaints, counterclaims, and related actions arising out of the same series of transactions, negotiations, and settlement of the *Shields* litigation have also been filed. *See RTC v. Alshuler et al.*, Civ. No. 93-0992; *RTC v. Kline,* Civ. No. 93-0509; *RTC v. Greenbaum,* Civ. No. 93-1256; *American Casualty Co. v. Thygerson. et al.*, Civ. No. 93-0010; *Reliance Insurance Co. v. Thygerson. et al.,* Civ. No. 93-0178; *Fidel v. Thygerson,* No. 93-1846; *American Casualty Co. v. Reliance Insurance Co.*, 94-0066.

relief, plaintiff claims that Shea defendants were negligent in their representation of ICA during the settlement of the *Shields* litigation and are thus liable for legal malpractice.

By order dated July 12, 1994, this Court denied Shea defendants' motion for summary judgment as to Claim 20 of the Second Amended Complaint. (Order Denying Shea Defendants' Motion for Summary Judgment and Granting in Part and Denying in Part Plaintiff's Motion for Leave to File Amended Complaint, dated July 12, 1994 [hereinafter July 12, 1994 Order].)[2]

In their motion for summary judgment, Shea defendants contended, inter alia, that the doctrines of claim and issue preclusion bar plaintiff's claims for malpractice and breach of fiduciary duty. Shea defendants argued that the court-approved settlement in the *Shields* litigation conclusively determined the fairness, reasonableness, and adequacy to ICA of the settlement and the terms therein; therefore, any claim that ICA was inadequately represented is barred.

In denying Shea defendants motion for summary judgment, the Court reasserted its previous holding that plaintiff was not provided with a full and fair opportunity to litigate the adequacy of the settlement. (July 12, 1994 Order at pp. 5-6. *See also,* February 24, 1993 Order at p. 7; Transcript of Proceedings before Hon. Judith Keep, dated August 17, 1992 at pp. 23-4.) The Court further held that the prior adjudication of the adequacy of a settlement does not collaterally estop a legal malpractice claim challenging the conduct of a party's lawyer during the prior action. (July 12, 1994 Order at p. 6.)

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2. Pursuant to this order, plaintiff filed his Third Amended Complaint on August 10, 1994.

Appendix B

II

DISCUSSION

Shea defendants now move this Court for an order certifying decision for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

As noted above, this Court faced a similar motion for certification for interlocutory appeal in the related RTC Actions.[3] By order filed October 20, 1994, this Court granted the Director defendants' motion to certify for interlocutory appeal this Court's order denying Director defendants' motion for summary judgment in the *RTC* Actions. (*See* Order Granting Director Defendants' Motion to Certify Decision for Interlocutory Appeal Pursuant to 28 U.S.C. § 1292(b), filed on October 20, 1994 in *RTC v. Alshuler,* Civ. No. 93-0992, and *RTC v. Greenbaum,* Civ. No. 93-1256 [hereinafter "Oct. 20, 1994 Order"].) With that order, this Court found that the following issue met the requirements for interlocutory appeal:

> Does the judgment of the United States District Court, Southern District of California, dated February 22, 1990, in *Shields v. Thygerson*, bar [certain] claims alleged by Resolution Trust Corporation, each of which asserts either that the director defendants breached a fiduciary duty in connection with acts related to entry of the judgment, or that the judgment effected a constructively fraudulent transfer of assets of Imperial Savings Association, or both?

3. Also as noted above, Shea defendants attempted to join in that motion; however, this court elected to treat such joinder as a separate motion.

(Oct. 20, 1994 Order.) Should the Ninth Circuit permit an appeal on this issue, the instant action will be directly affected in that plaintiff Durkin alleges similar breach of fiduciary duty and fraudulent transfer causes of action against Director defendants in *Durkin v. Shields*. In fact, the Court considered the similarity of issues in the *RTC* Actions and the instant action as weighing in favor of certification in that a decision by the Ninth Circuit would materially advance the complex litigation and numerous actions arising out of the *Shields* litigation.

Shea defendants' motion to certify decision for interlocutory appeal is different from the Director defendants' motion in the RTC Actions in that the claim against the Shea defendants is one of legal malpractice, rather than breach of fiduciary duty. However, the underlying issue in both the instant motion and motion in the *RTC* Actions is what preclusive effect does a court-approved settlement have on subsequent claims by a party or privy to the settlement. Accordingly, Shea defendants moved to join in the Directors defendants' motion or, in the alternative, to have the following issue certified for appeal:

> Whether the underlying Final Judgment of Dismissal with Prejudice by the United States District Court, Southern District of California, dated February 22, 1990, in *Shields v. Thygerson* ("Judgment"), entered upon Federal Rules of Civil Procedure 23 and 23.1 proceedings and approving the derivative litigation settlement at issue ("*Shields* Settlement") conclusively determined as a matter of law the fairness, reasonableness, and adequacy to ICA of the *Shields* settlement and the terms therein.

(Joinder in Director Defs.'s M. Cert. at p. 2.) The issue upon which Shea defendants seek certification arises out of this Court's July 12, 1994 Order denying Shea defendants' motion for summary judgment.

Given the similarity of the issue presented by Shea defendants to the issue already certified, the complexity of the litigation arising out of the *Shields* settlement, and this Court's concern for judicial efficiency and economy, this Court incorporates its reasoning of the Oct. 20, 1994 Order in the *RTC* Actions and finds that Shea defendants have met the statutory requirements for certification for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).[4]

IT IS ORDERED that Shea defendants' motion to certify decision for interlocutory appeal, joined in by Former Actions Class and Derivative defendants, is **HEREBY GRANTED.**

IT IS SO ORDERED.

Dated: 12/8/94

s/ Irma E. Gonzalez
IRMA E. GONZALEZ
United States District Judge

Copies distributed/mailed (see pages 8-13 attached hereto and incorporated herein by reference).

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4. The Court notes that although the preclusive effect of a court-approved settlement on subsequent claims for legal malpractice raises slightly different legal issues and requires looking at precedent other than that discussed in the Oct. 20, 1994 Order in the *RTC* Actions, Shea defendants' motion also presents a controlling question of law over which a substantial ground for difference of opinion exists. See 28 U.S.C.A. § 1292(b) (1993).

APPENDIX C — COURT OF APPEALS' ORDER GRANTING PETITION TO APPEAL PURSUANT TO 28 U.S.C. § 1292(b)

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 94-1003-IEG

DC# CV-92-1003-IEG
Southern California

RONALD L. DURKIN, Trustee,

Plaintiff-Respondent,

vs.

SHEA & GOULD, et al.,

Defendants-Petitioners.

No. 94-80461

DC# CV-92-1003-IEG
Southern California

RONALD L. DURKIN, Trustee,

Plaintiff-Respondent,

vs.

MILBERG, WIESS, BERSHAD, HYNEX & LEARCH, et al.,

Defendants-Petitioners.

Appendix C

Before: BROWNING and T.G. NELSON, Circuit Judges

The petitions for permission to appeal pursuant to 28 U.S.C. § 1292(b) are granted. Within 10 days of the date of this order, petitioners shall perfect these appeals pursuant to Fed. R. App. P. 5(d).

[stamped]
A TRUE COPY
CATHY A. CATTERSON
Clerk of Court
ATTEST
APR 06, 1995

by: s/ illegible
Deputy Clerk

APPENDIX D — *DURKIN V. SHEA & GOULD*, 92 F.3D 1510 (9TH CIR. 1996)

Ronald L. DURKIN, Trustee of the Benchmark Irrevocable Trust, Plaintiff-Appellee,

v.

SHEA & GOULD; Sheldon Camhy, Defendants-Appellants.

Ronald L. DURKIN, Plaintiff-Appellee,

v.

MILBERG, WEISS, BERSHAD, HYNES & LERACH, et.al., Defendants-Appellants.

Nos. 95-55432, 95-55434.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted April 11, 1996.

Decided August 19, 1996.

* * *

Appeals from the United States District Court for the Southern District of California, Irma E. Gonzalez, District Judge, Presiding. D.C. Nos. CV-92-01003-IEG, CV-92-01003-IEG.

Appendix D

Before: O'SCANNLAIN and TROTT, Circuit Judges, and VAN SICKLE,* District Judge.

O'SCANNLAIN, Circuit Judge:

In this second of two related cases[1] arising out of the failure of Imperial Savings Association, we must decide whether a court-approved settlement of a shareholder derivative suit precludes a subsequent action for legal malpractice.

I

The law firm of Shea & Gould interlocutorily appeals the district court's order denying summary judgment in an action brought by Ronald L. Durkin alleging that the law firm breached a fiduciary duty and demonstrated negligence in its representation of Imperial Corporation of America ("ICA"), the parent corporation of failed savings and loan Imperial Savings Association ("ISA"). As representative of the ICA bankruptcy estate,[2] Durkin alleges that Shea & Gould, ICA's attorneys, committed legal malpractice in settling a class action shareholder

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* The Honorable Bruce M. Van Sickle, Senior United States District Judge for the District of North Dakota, sitting by designation.

1. Today, we also decide the related case of *FDIC v. Alshuler,* 92 F.3d 1503 (9th Cir.1996).

2. On February 28, 1990, ICA filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Under ICA's Chapter 11 reorganization plan, ICA transferred certain assets to the Benchmark Irrevocable Trust, of which Durkin is the court-appointed trustee. Durkin claims authorization to assert all rights of ICA and its bankruptcy estate, and to investigate and pursue ICA's claims against its former directors, officers, and attorneys.

derivative suit, *Shields v. Thygerson,*[3] on the same day that federal regulators ordered the seizure of ISA. The district court concluded that the *Shields* settlement did not preclude Durkin's action.

The *Shields* settlement resolved consolidated shareholder derivative and federal securities class actions involving ICA's investments in junk bonds and consumer loans. These investments arose from transactions with Michael Milken and Drexel Burnham Lambert in the late 1980s. ICA retained Shea & Gould to assist in connection with the settlement of the derivative and class actions. The shareholder plaintiffs were represented by Milberg, Weiss, Bershad, Specthrie & Lerach[4] and a host of other firms.

The parties prepared a Stipulation of Settlement, which provided that American Casualty Company would make a $12.5 million payment to an escrow fund, of which $10 million would be "deemed" to be in settlement of the class actions and $2.5 million would be "deemed" to be in settlement of the derivative actions. ICA was obligated to contribute an additional $500,000 to the escrow fund, creating a total settlement fund of $13 million for payment to the plaintiffs in the class actions. The settlement released the directors and officers of ICA from any claims that might have been brought against them by ICA or ISA.

On December 15, 1989, the ICA Board approved the

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3. *Shields v. Thygerson,* Civ. No. 39-0126-JLI(M) (S.D.Cal. Feb. 22, 1990).

4. The firm is now known as Milberg, Weiss, Bershad, Hynes & Lerach.

Stipulation of Settlement.[5] At a hearing on February 22, 1990, U.S. Magistrate Judge Harry McCue approved the settlement under Federal Rules of Civil Procedure 23 and 23.1 and signed the final judgment.[6] Magistrate Judge McCue concluded that (1) the notice provided to shareholders was "the best notice practicable under the circumstances"; (2) the settlement was "the product of good faith arm's length negotiations"; and (3) the settlement was "fair, reasonable and adequate as to" ICA and the shareholders.

On the same day that Magistrate Judge McCue approved the settlement, the United States Office of Thrift Supervision ordered the seizure of ICA's savings and loan, ISA, and placed it into conservatorship under the Resolution Trust Corporation ("RTC"). OTS Order No. 90-375 (Feb. 22, 1990). On February

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5. All members of ICA's board were named defendants in the *Shields* suit. According to Durkin, each director "faced personal exposure exceeding $100 million."

6. Under Federal Rule of Civil Procedure 23(e), the district court determines whether a proposed settlement is "fundamentally fair, adequate, and reasonable." *In re Pacific Enters. Sec. Litig.*, 47 F.3d 373, 377 (9th Cir.1995) (internal quotation marks and citations omitted). Rule 23.1 provides that a shareholder derivative action "may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." Rule 23.1 also requires that "[t]he action shall not be dismissed or compromised without the approval of the court." Fed. R.Civ.P. 23.1. "Before approving a class action settlement, the district court must reach a reasoned judgment that the proposed agreement is not the product of fraud or overreaching by, or collusion among, the negotiating parties." *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1290 (9th Cir.) (internal quotation marks and citations omitted), *cert. denied sub nom. Hoffer v. City of Seattle*, 506 U.S. 953, 113 S.Ct. 408, 121 L.Ed.2d 333 (1992).

28, 1990, ICA filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.[7]

Durkin brings this action against ICA's directors and the attorneys responsible for the *Shields* settlement, alleging that (1) the directors, assisted by counsel, breached their fiduciary duties and engaged in fraudulent transfers when arranging this settlement, and (2) the attorneys committed malpractice. Durkin contends that the settlement resulted from malpractice, collusion, conflicts of interest, nondisclosure, and misrepresentation.

Durkin seeks to recover damages of at least $30 million from Shea & Gould, which ICA retained to facilitate settlement negotiations in cooperation with Baker & McKenzie, ICA's counsel of record in the derivative actions. Durkin alleges that Shea & Gould failed to advise the directors either of the need to remedy the Board's complete conflict of interest in approving the settlement, or of the gross unfairness of the consideration paid for the release of what counsel knew to be substantial derivative claims. Durkin further alleges that Magistrate Judge McCue was never told of ICA's insolvency, the imminent seizure of ISA by federal regulators, or the substantial and meritorious nature of the charges against the directors.

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7. Shea & Gould is also in bankruptcy. On December 22, 1995, the firm filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. On February 21, 1996, the Bankruptcy Court modified the automatic stay for the sole purpose of allowing Shea & Gould to proceed with this appeal, pursuant to section 362(d)(1) of the Bankruptcy Code. *See* Notice of Relief From Automatic Stay exhibit C (filed Mar. 11, 1996).

Appendix D

Shea & Gould moved for summary judgment or partial summary judgment on the grounds that the *Shields* judgment collaterally estops Durkin from litigating the following issues: (1) whether the *Shields* settlement was fair, reasonable, and adequate as to ICA, and (2) whether ICA was adequately represented by the derivative shareholder plaintiffs.

In its July 12, 1994 Order, the district court denied Shea & Gould's motion for summary judgment or partial summary judgment on the malpractice claim. The court held that collateral estoppel does not apply because Durkin did not have a full and fair opportunity to litigate the adequacy of the settlement. In addition, the court held that the prior adjudication of the settlement's adequacy does not collaterally estop a legal malpractice claim challenging the conduct of a party's attorney during the prior action.

On Shea & Gould's motion, the district court certified its July 12, 1994 decision for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). Appellants Milberg Weiss et al. in the companion case (No. 95-55434) were deemed to have joined in Shea & Gould's motion to certify the July 12, 1994 Order. By an order filed on April 6, 1995, a motions panel of this court granted Shea & Gould's and Milberg Weiss' petitions for permission to appeal pursuant to 28 U.S.C. § 1292(b). On July 19, 1995, the district court stayed all discovery pending the outcome of this appeal.

II

As a threshold matter, we must determine whether we have jurisdiction over the claims raised in the companion case of *Durkin v. Milberg Weiss* (No. 95-55434).

Appendix D

The appellants in *Milberg Weiss* were the representative shareholder plaintiffs[8] and their attorneys in the *Shields* litigation. Before the district court, Appellee Durkin asserts (1) breach of fiduciary duty claims against the shareholder plaintiffs; and (2) fraudulent transfer claims against both the shareholder plaintiffs and their attorneys based on their receipt of settlement proceeds. The shareholder plaintiffs and their attorneys argue that res judicata bars all of Durkin's claims against them.

The fiduciary duty and fraudulent transfer claims are the subject of district court orders that are not before us.[9] In addition, we note that the district has not certified for appeal its December 1, 1993 Order dismissing Durkin's malpractice claims against the shareholder plaintiffs' attorneys. The only proper subject of this appeal is the section of the July 12, 1994 Order in which the district court denied Shea & Gould's motion for summary judgment or partial summary judgment on Durkin's malpractice claim.

It is true that the issue submitted by Shea & Gould to the district court for certification appears to be broad ("[whether the final judgment approving the *Shields* settlement] conclusively determined as a matter of law the fairness, reasonableness, and adequacy to ICA of the *Shields* settlement and the terms therein"). It is also true that the shareholder

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8. Rodney B. Shields, Three Bridges Investment Group, William Steiner, Sonem Partners, and Max Grill.

9. For example, in a February 24, 1993 Order, the district court declined to dismiss the fraudulent transfer claims as a collateral attack on the settlement barred by res judicata, holding that ICA lacked a "full and fair" opportunity to litigate. The district court has not certified this order for appeal.

plaintiffs and their attorneys filed a memorandum in support of Shea & Gould's motion to certify, and that the district court deemed this memorandum a "joinder in the Shea defendants' motion to certify." However, in its order granting certification, the district court emphasized that the "issue upon which Shea defendants seek certification arises out of this Court's July 12, 1994 Order denying Shea defendants' motion for summary judgment."[10]

Since an appeal under section 1292(b) "is from the *certified order,* [and] not from any other orders that may have been entered in the case," *United States v. Stanley,* 483 U.S. 669, 677, 107 S.Ct. 3054, 3060, 97 L.Ed.2d 550 (1987)[11] we lack jurisdiction to consider the shareholder plaintiffs and their attorneys' arguments concerning the fiduciary duty and fraudulent transfer claims. *See also Swint v. Chambers County Comm'n,* __U.S. __, __, 115 S.Ct. 1203, 1211, 131 L.Ed.2d 60 (1995) (citing *Stanley,* 483 U.S. at 676-77, 107 S.Ct. at 3059-60) ("appellate review [is] limited to the certified order; issues presented by other, noncertified orders could not be considered simultaneously").[12] Moreover, since the district court's dismissal

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10. The district court specifically noted that "the preclusive effect of a court-approved settlement on subsequent claims for legal malpractice raises slightly different legal issues and requires looking at precedent other than that discussed in [another order issued by the district court]."

11. "Even if the Court of Appeals' jurisdiction is not confined to the precise question certified by the lower court (because the statute brings the 'order,' not the question, before the court), that jurisdiction *is* confined to the particular order appealed from." *Stanley,* 483 U.S. at 677, 107 S.Ct. at 3060.

12. Of course, we "may address those issues *material* to the order from which appeal has been taken." *In re Cinematronics, Inc.,* 916 F.2d 1444, (Cont'd)

of the malpractice claims against the shareholder plaintiffs' attorneys has not been certified for appeal, we do not even have jurisdiction to consider these claims. *See Libby, McNeill, & Libby v. City Nat'l Bank,* 592 F.2d 504, 511 (9th Cir.1978) ("a party may only appeal to protect its own interests, and not those of a co-party").[13] Accordingly, we dismiss the appeal in No. 95-55434 for lack of appellate jurisdiction.

III

We now consider the applicability of issue preclusion to Durkin's malpractice claims against Shea & Gould in the lead case (No. 95-55432).

The doctrine of issue preclusion (collateral estoppel) bars relitigation of issues "actually litigated and necessarily determined by a court." *Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1518 (9th Cir.1985) (citing *Montana v. United States,* 440 U.S.

(Cont'd)
1449 (9th Cir. 1990) (citations omitted). However, we reject Milberg Weiss' contention at oral argument that the district court's earlier order (declining to dismiss Durkin's fraudulent transfer claims) was somehow certified for appeal because the July 12, 1994 Order contains a passing reference to the earlier order.

13. *See Morrison-Knudsen Co., Inc. v. CHG Int'l, Inc.*, 811 F.2d 1209, 1214 (9th Cir.1987) (citing Fed.R.Civ.P. 12(h)(3)) ("A motions panel of this court previously ruled that we had jurisdiction here under 28 U.S.C. § 1292(a)(1). We cannot agree, however, and are bound to note a defect in appellate jurisdiction whenever one appears."), *cert. dismissed sub nom. Federal Sav. & Loan Ins. Corp. v. Stevenson Assoc.*, 488 U.S. 935, 109 S.Ct. 358, 102 L.Ed.2d 349 (1988).

147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979)). Issue preclusion applies in "subsequent suits based on a different cause of action involving a party to the prior litigation." *Montana*, 440 U.S. at 153, 99 S.Ct. at 973.

The Supreme Court has recognized that special circumstances — such as "reason to doubt the quality, extensiveness, or fairness of procedures followed in prior litigation"— may "warrant an exception to the normal rules of preclusion." *Id.* at 155, 164 n. 11, 99 S.Ct. at 974-75, 979 n. 11. In short, the parties must have had "a full and fair opportunity to litigate." *Id.* at 153, 99 S.Ct. at 973; *see Kremer v. Chemical Constr. Co.*, 456 U.S. 461, 480-81 & n. 22, 102 S.Ct. 1883, 1897 & n. 22, 72 L.Ed.2d 262 (1982) (citations omitted) ("collateral estoppel does not apply when the party against whom the earlier decision is asserted did not have a 'full and fair opportunity' to litigate the claim or issue [in the earlier case]"). Furthermore, this court has stated that "[i]f there is doubt, . . . collateral estoppel will not be applied." *Davis & Cox*, 751 F.2d at 1518 (citation omitted).

A

In the district court, Shea & Gould argued that Magistrate Judge McCue's approval of the *Shields* settlement conclusively resolved the fairness, adequacy, and reasonableness of the settlement as to ICA and the adequacy of the shareholder plaintiffs' representation of ICA, thus precluding relitigation of issues crucial to Durkin's malpractice claim against Shea & Gould.

The district court provided five reasons for denying Shea and Gould's motion.

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First, the court concluded that neither claim nor issue preclusion applies to Durkin because he did not have a "full and fair opportunity" to litigate the adequacy of the settlement. *See Kremer,* 456 U.S. at 480-81 & n. 22, 102 S.Ct. at 1897 & n. 22.

Second, the court held that the "prior adjudication of the adequacy of a settlement does not collaterally estop a legal malpractice claim challenging the conduct of a party's lawyer during the prior action because the essence of such a claim is that the Court's decision approving the settlement would have been different absent the negligence of the party's attorney." *See Ruffalo v. Patterson,* 234 Cal.App.3d 341, 285 Cal.Rptr. 647, 648 (1991).

Third, the court concluded that Durkin is not precluded from claiming that Shea & Gould inadequately represented ICA because "that issue was not actually litigated in the underlying actions." The court noted that the legal malpractice claim did not even accrue until the settlement became final and that Durkin could not have asserted the claim until he was appointed representative of the ICA bankruptcy estate. *See Davis &* Cox, 751 F.2d at 1518.

Fourth, the court stated that "any finding by Judge McCue as to the adequacy of the derivative shareholder plaintiffs' representation of ICA is not dispositive of the issue of whether the Shea Defendants breached any duty owed to ICA."

Fifth, the court concluded that the issue of whether Shea & Gould breached any duty to ICA in connection with the *Shields* litigation is a "factual issue that can only be properly resolved once the relevant discovery . . . can be reviewed."

Appendix D

B

On appeal, Shea & Gould argues that the district court erred because (1) the basic elements of issue preclusion are present; (2) ICA had a "full and fair opportunity" to litigate; (3) issue preclusion is not made unavailable to Shea & Gould simply because it represented ICA as a nominal defendant; and (4) Durkin's collateral attack threatens important public interests. These arguments lack merit and will be addressed in turn.

1

The elements of issue preclusion are: (1) the issue decided in the prior adjudication is substantially identical to the issue in the subsequent action; (2) there was a final judgment on the merits; and (3) the party against whom the estoppel is asserted was a party to or in privily with a party in the first action. *Pension Trust Fund for Operating Eng'rs v. Triple A Machine Shop, Inc.*, 942 F.2d 1457, 1462 (9th Cir.1991) (citations omitted).

It is undisputed that the second (final judgment) and third (privity) elements of issue preclusion are present here. The *Shields* settlement was court-approved and entered as a final judgment. Durkin is in privity with ICA, a party to the *Shields* settlement, because Durkin claims that ICA assigned its malpractice claims to him. The only element in dispute is the first (identical issue).

Under California law, the plaintiff bringing a malpractice action must prove (1) the existence of a duty; (2) the negligent act or omission; (3) the proximate causation of plaintiff's damages; and (4) the measure of damages. *Sukoff v. Lemkin,*

202 Cal.App.3d 740, 249 Cal.Rptr. 42, 44 (1988). Shea & Gould asserts that in order to prove causation and damages, Durkin must prove that at the time of the settlement, the settlement was not reasonable and that the defendants would have agreed to pay a greater amount than they actually paid. *See id.* 249 Cal. Rptr. at 47-48. Shea & Gould argues that Magistrate Judge McCue's finding that the settlement was fair, reasonable, and adequate necessarily and actually decided the causation and damages issues that Durkin is now attempting to litigate, thus precluding Durkin from establishing elements crucial to his malpractice action.

We are not persuaded by Shea & Gould's argument that Durkin's malpractice action raises the same issues actually and necessarily decided by Magistrate Judge McCue. In fact, Durkin's malpractice action raises two distinct issues that were not decided by Magistrate Judge McCue: (1) whether Shea & Gould adequately represented the interests of ICA, with particular regard to ICA's obligations to its creditors at a time when ICA was either insolvent or perilously close to insolvency; and (2) whether the *Shields* settlement was reasonable for the purposes of a malpractice suit.

First, as required by Rule 23.1, Magistrate Judge McCue determined that the shareholder plaintiffs adequately represented similarly situated shareholders. *See Larson v. Dumke,* 900 F.2d 1363, 1367 (9th Cir.), *cert. denied sub nom. Round Table Pizza, Inc. v. Larson,* 498 U.S. 1012, 111 S.Ct. 580, 112 L.Ed.2d 585 (1990). Magistrate Judge McCue did not decide that the shareholder plaintiffs and their attorneys adequately represented the full corporate interests of ICA; nor did Magistrate Judge McCue specifically find that Shea & Gould adequately represented the interests of a corporation on the eve of its

bankruptcy. Moreover, as the district court correctly stated, Durkin's malpractice action did not even accrue until the settlement was final. *See Davis & Cox,* 751 F.2d at 1518.

Second, the issue of whether a settlement was "fair and adequate" for the purposes of Rule 23.1 is not the same issue as whether the settlement was reasonable in light of alleged malpractice by the participating attorneys. As the New Jersey Supreme Court concluded: "The fact that a party received a settlement that was 'fair and equitable' does not mean necessarily that the party's attorney was competent or that the party would not have received a more favorable settlement had the party's incompetent attorney been competent." *Ziegelheim v. Apollo,* 128 N.J. 250, 607 A.2d 1298, 1305 (1992); *accord In re Danelson,* 142 B.R. 932, 938-39 (Bankr. D.Mont.1992); *Ruffalo v. Patterson,* 285 Cal. Rptr. at 648; *Garcia v. Borelli,* 129 Cal. App.3d 24, 180 Cal.Rptr. 768, 772 (1982).

2

Shea & Gould contends that ICA had a "full and fair opportunity" to litigate because (1) Rule 23.1 procedures protected ICA's interests; and (2) the shareholder plaintiffs represented ICA's interests in the *Shields* litigation. *See Breswick & Co. v. Briggs,* 135 F.Supp. 397, 403 (S.D.N.Y.1955) (footnote omitted) ("the 'real party in interest' in . . . derivative actions is the corporation itself but the real parties *in litigation* are those stockholders who are undertaking the trouble and expense of establishing the rights of the corporation"). Shea & Gould relies on Magistrate Judge McCue's determinations that the shareholder plaintiffs adequately represented the class and that the settlement was fair, adequate, and reasonable as to ICA and its shareholders. We are not persuaded that these arguments justify precluding a malpractice action.

Appendix D

Durkin alleges that the imminent seizure of ISA and bankruptcy of ICA gave all of the parties to the *Shields* settlement "powerful reasons — not disclosed to the Magistrate — to push a quick settlement through the court *before* the seizure and bankruptcy placed the corporation and its assets under the protection of the bankruptcy court, the RTC, and ICA's trustee." Further, Durkin alleges a number of nondisclosures and conflicts of interest, including the retention of Shea & Gould by ICA Board Chairman and *Shields* defendant Allan R. Tessler, who was also "of counsel" to Shea & Gould at the time of the *Shields* litigation.

Since a malpractice action does not even accrue until after the settlement becomes final, it necessarily follows that the *Shields* proceedings could not have provided Durkin with a "full and fair opportunity" to litigate the adequacy of the settlement for the purposes of a subsequent malpractice action. *See Ruffalo,* 285 Cal.Rptr. at 648.[14]

3

Claiming that the district court misunderstood the basic principles of shareholder derivative litigation, Shea & Gould stresses that it "never was asked to represent ICA's interests as a plaintiff, never purported to do so, and there was absolutely no evidence before the district court that it undertook a duty to do so." Rather, Shea & Gould asserts that ICA retained the firm to

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14. *See generally* Deborah A. Klar, The Settlement of Class and Derivative Actions on the Eve of Bankruptcy, 659 Practising Law Institute/ Commercial Law and Practice Course Handbook Series 389 (PLI Order No A4-4416) (May-June 1993) ("[A] variety of claims may be successfully asserted against the participants [in a "settlement on the eve of bankruptcy"]. For example, they may be subject to liability . . . for breach of duty or malpractice.").

provide services to ICA "as a nominal defendant" in the derivative actions. As such, Shea & Gould asserts that the firm had "no duty to maximize ICA's recovery as a plaintiff" because the firm represented ICA "only as a nominal defendant."

The shareholder plaintiffs, according to Shea & Gould, prosecuted the interests of ICA as a plaintiff.[15] Thus, Shea & Gould argues that it could not have affected the derivative actions' outcome from ICA's perspective as a plaintiff. The firm further contends that no general rule of law supports the district court's conclusion that Shea & Gould should be denied the benefit of issue preclusion from a judgment that allegedly resulted from the firm's purported malpractice. These arguments lack merit.

First, the existence and nature of any duties owed by Shea & Gould to ICA raise questions of fact that are not properly before us. As the district court concluded, "whether the Shea defendants breached any duty to ICA in connection with the *Shields* litigation and settlement is a factual issue that can only be properly resolved once the relevant discovery, which has barely begun, can be reviewed."

Second, although the California courts have not considered issue preclusion in the context of a Rule 23.1 settlement, they have consistently held that a court-approved settlement or judgment does not immunize an attorney from a subsequent

15. *See Kamen v. Kemper Fin. Servs.*, 500 U.S. 90, 95, 111 S.Ct. 1711, 1716, 114 L.Ed.2d 152 (1991) (citations omitted) ("The derivative form of action permits an individual shareholder to bring 'suit to enforce a *corporate* cause of action against officers, directors, and third parties.' Devised as a suit in equity, the purpose of the derivative action was to place in the hands of the individual shareholder a means to protect the interests of the corporation. . . .").

malpractice action. *See, e.g., Ruffalo,* 285 Cal.Rptr. at 648 (involving court-approved settlement); *Garcia v. Borelli,* 180 Cal.Rptr. at 772 (same); *Pete v. Henderson,* 124 Cal.App.2d 487, 269 P.2d 78, 79-80 (1954) (involving final judgment); *accord In re Danelson,* 142 B.R. at 939 (involving court-approved settlement). As the California Court of Appeal has observed: "To hold otherwise would be to rule that where an attorney's negligence has caused a court to make an erroneous adjudication of an issue, the fact that the court has made that adjudication absolves the attorney of all accountability and responsibility for his negligence." *Ruffalo,* 285 Cal.Rptr. at 648.

Of course, it is true that courts have precluded subsequent derivative claims by class members collaterally attacking settled derivative actions, *see, e.g., Grimes v. Vitalink Communications Corp.,* 17 F.3d 1553, 1557-58 (3d Cir.), *cert. denied,* __ U.S. __, 115 S.Ct. 480, 130 L.Ed.2d 393 (1994), but here Durkin is clearly *not* bringing a subsequent derivative action. Furthermore, Shea & Gould's reliance on *Valerio v. Boise Cascade Corp.,* 80 F.R.D. 626 (N.D.Cal.1978), *aff'd,* 645 F.2d 699, 700 (9th Cir.) (adopting district court's opinion), *cert. denied,* 454 U.S. 1126, 102 S.Ct. 976, 71 L.Ed.2d 113 (1981), is misplaced because *Valerio is* clearly distinguishable. In *Valerio,* class members (who had elected not to opt out) alleged malpractice in an effort to reopen a settlement in which they had participated. Contrary to Shea & Gould's assertion that the court applied res judicata to bar the malpractice claims, the court in fact barred the claims on the grounds that the relevant statute of limitations had run. 80 F.R.D. at 632.[16]

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16. Shea & Gould's reliance on *In re One Bancorp Sec. Litig.,* 151 B.R. 1, 3 (D.Me.1993), and *In re Pinto Trucking Serv.,* 93 B.R. 379, 389-90 (Bankr.E.D.Pa.1988), is also misplaced. Both cases addressed whether litigants could make sufficient showings of constructively fraudulent transfers

(Cont'd)

Finally, Shea & Gould argues that Durkin's malpractice action threatens important public interests in (1) encouraging settlement;[17] (2) enforcing finality and avoiding repetitious litigation; and (3) implementing the policies underlying Rules 23 and 23.1[18]

Indeed, courts have recognized the interests asserted by Shea & Gould, but courts have also stressed that special circumstances may "warrant an exception to the normal rules of preclusion," *see Montana,* 440 U.S. at 155, 163, 99 S.Ct. at 974-75, 978-79, and that attorneys are not immunized from malpractice suits simply because they arranged a court-approved settlement, *see Ruffalo,* 285 Cal.Rptr. at 648.

In short, we hold that a court-approved, shareholder derivative settlement pursuant to Rule 23.1 does not immunize participating attorneys from subsequent malpractice actions.

(Cont'd)
under the Bankruptcy Code; neither case concerned malpractice. *See In re Pinto,* 93 B.R. at 390 (noting that "all of the neutral participants . . . strongly recommended [the settlement]" and that there was "no suggestion that 'fraud or collusion' played any role in the negotiation of the settlement").

17. *See In re Pacific Enters. Sec. Litig.*, 47 F.3d 373, 378 (9th Cir.1995) (internal quotation marks and citation omitted) (noting "strong judicial policy that favors settlement").

18. *See Valerio,* 80 F.R.D. at 649 ("[R]estricting the *res judicata* effect of class action settlements would lessen a defendant's incentive to settle. . . .").

Appendix D

IV

For the foregoing reasons, we affirm the district court's July 12, 1994 Order in *Durkin v. Shea & Gould,* and dismiss the appeal in *Durkin v. Milberg Weiss* for lack of appellate jurisdiction.

No. 95 55432 **AFFIRMED.**

No. 95 55434 **DISMISSED** for lack of appellate jurisdiction.

APPENDIX E — COURT OF APPEALS' JUDGMENT ENTERED AUGUST 19, 1996

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NO. 95-55432
CT/AG#: CV-92-01003-IEG

RONALD L. DURKIN, Trustee of the Benchmark Irrevocable Trust

Plaintiff-Appellee

v.

SHEA & GOULD; SHELDON CAMHY

Defendants-Appellants

NO. 95-55434
CT/AG#:CV-92-01003-IEG

RONALD L. DURKIN

Plaintiff-Appellee

v.

MILBERG, WEISS, BERSHAD, HYNES & LERACH, et al.

Defendants-Appellants

APPEAL FROM the United States District Court for the Southern District of California (San Diego).

Appendix E

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California (San Diego) and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is AFFIRMED in No. 95-55432 and the appeal in No. 95-55434 is DISMISSED. Costs taxed.

Filed and entered August 19, 1996.

APPENDIX F — COURT OF APPEALS' ORDER DENYING APPELLANT'S PETITION FOR REHEARING FILED NOVEMBER 25, 1996

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 95-55432
D.C. No. CV-92-01003-IEG

RONALD L. DURKIN, Trustee of the Benchmark Irrevocable Trust,

Plaintiff-Appellee,

v.

SHEA & GOULD; SHELDON CAMHY,

Defendants-Appellants.

ORDER

Before: O'SCANNLAIN and TROTT, Circuit Judges; VAN SICKLE,* District Judge.

The panel has voted to deny appellant's petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P 35.

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* The Honorable Bruce M. Van Sickle, Senior United States District Judge for the District of North Dakota, sitting by designation.

Appendix F

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

APPENDIX G — *IN RE IMPERIAL CORP. OF AMERICA*, 92 F.3d 1503 (9th Cir. 1996)

In re IMPERIAL CORP. OF AMERICA, Related Litigation.

FEDERAL DEPOSIT INSURANCE CORPORATION,* in its corporate capacity and as receiver for Imperial Federal Savings Association, Plaintiff-Appellant,

v.

Robert S. ALSHULER, Defendant,

and

Barclay Davidson, Michael Lea, and Anthony E. Maniscalco, II, Defendants-Appellees.

FEDERAL DEPOSIT INSURANCE CORPORATION, in its corporate capacity and as receiver for Imperial Federal Savings Association, Plaintiff-Appellant,

v.

Mark L. KLINE, Defendant-Appellee.

FEDERAL DEPOSIT INSURANCE CORPORATION, in its

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* On June 22, 1990, the Resolution Trust Corporation ("RTC") became receiver of Imperial Savings Association ("ISA"), and the United States Office of Thrift Supervision transferred ISA's assets and liabilities to a new entity, Imperial Federal Savings Association ("IFSA"), of which the RTC became conservator. On December 31, 1995, pursuant to 12 U.S.C. § 1441a(m)(1), the Federal Deposit Insurance Corporation ("FDIC") assumed responsibility for the functions of the RTC and acquired its assets and liabilities. Accordingly, the FDIC is the statutory successor to the RTC in its corporate capacity and as receiver for ISA.

Appendix G

corporate capacity and as receiver for Imperial Federal Savings Association, Plaintiff-Appellant,

v.

Robert S. ALSHULER, et al., Defendants,

and

Gary M. Cypres, Defendant-Appellee.

Nos. 95-55233, 95-55236, 95-56045.

United States Court of Appeals,
Ninth Circuit

Argued and Submitted April 11, 1996.
Decided Aug. 19, 1996.

* * *

Appeals from the United States District Court for the Southern District of California, Irma E. Gonzalez, District Judge, Presiding. D.C. Nos. CV-93-0992-IEG, CV-93-0509-IEG and CV-93-0992-IEG.

Before: O'SCANNLAIN and TROTT, Circuit Judges; VAN SICKLE,** District Judge.

** The Honorable Bruce M. Van Sickle, Senior United States District Judge for the District of North Dakota, sitting by designation.

Appendix G

O'SCANNLAIN, Circuit Judge:

In the first of two related cases[1] arising out of the failure of the Imperial Savings Association, we must decide whether a court-approved settlement of a shareholder derivative suit precludes the receiver from bringing mismanagement claims against former officers and directors.

I

The Federal Deposit Insurance Corporation ("FDIC"), as receiver for failed savings and loan Imperial Savings Association ("ISA"), appeals the district court's summary judgment for ISA's former officers and directors in the FDIC's actions for negligence and breach of fiduciary duty (the "mismanagement claims"). The district court concluded that claim preclusion barred the FDIC from obtaining judgment against the officers and directors because of a court-approved, class action shareholder derivative suit, *Shields v. Thygerson*,[2] which settled shortly before federal regulators seized ISA.

ISA, a San Diego-based savings and loan, was a wholly-owned subsidiary of Imperial Corporation of America ("ICA"), a financial institution holding company. ICA and ISA shared the same board of directors. The *Shields* settlement resolved consolidated shareholder derivative and federal securities class actions involving ICA's investments in junk bonds and consumer loans. These investments arose from transactions with Michael

1. Today, we also decide the related case of *Durkin v. Shea & Gould*, 92 F.3d 1510 (9th Cir.1996).

2. *Shields v. Thygerson*, Civ. No. 89-0126-JLI(M) (S.D.Cal. Feb. 22, 1990).

Milken and Drexel Burnham Lambert in the late 1980s.

Appellees Barclay Davidson, Mark L. Kline, Michael Lea, and Anthony E. Maniscalco II (collectively "the officers") were ISA officers between 1987 and 1989 and were allegedly involved in imprudent investments and transactions. Appellee Gary M. Cypres served on the ICA and ISA boards as an outside director from March 1987 to December 1988.[3]

Davidson claims that he was only an officer (vice president) of ISA between May and July of 1988, and that he was "a mere employee" (marketing representative) when the allegedly imprudent loans were arranged prior to January 1988. According to the FDIC's complaint, Kline was "Executive Officer in charge of First Financial Equities Corporation," an ISA subsidiary "involved in acquisition of real estate, and was a member of the Executive Lending and Investment Committee, which was responsible for credit risk underwriting of all lending investments" at ISA. In the *Shields* complaint, Lea was named as a "Senior Vice-President Financial and Economic Analysis" of ICA. Maniscalco took part in a $16 million loan made in 1988 by ISA to Global Motors, the importer of the Yugo automobile — the loan went into default. Although Maniscalco was not named in the *Shields* complaint, the complaint referred to the defaulted Global Motors loan, which is also cited in the FDIC's allegations against Maniscalco.

The *Shields* class action and derivative complaint alleged violations of federal securities laws, the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and relevant state laws. The complaint specifically alleged that between 1987 and

3. *FDIC v. Cypres* (No. 95-56045) raises precisely the same issues presented in the *Davidson* and *Kline* appeals.

1989, officers and directors of ICA and ISA engaged in imprudent financial policies, including inadvisable loans.

The parties prepared a Stipulation of Settlement, which provided that American Casualty Company would make a $12.5 million payment to an escrow fund, of which $10 million would be "deemed" to be in settlement of the class actions and $2.5 million would be "deemed" to be in settlement of the derivative actions. ICA was obligated to contribute an additional $500,000 to the escrow fund, creating a total settlement fund of $13 million for payment to the plaintiffs in the class actions. The settlement released the directors and officers of ICA and ISA from any claims that might have been brought against them by ICA or ISA.

On December 15, 1989, the ICA Board approved the Stipulation of Settlement.[4] The settlement included ICA, ISA, and all ICA subsidiaries and affiliates in the definition of "Signatory Defendants." At a hearing on February 22, 1990, U.S. Magistrate Judge Harry McCue approved the settlement under Federal Rules of Civil Procedure 23 and 23.1 and signed the final judgment.[5] Magistrate Judge McCue concluded that (1)

4. All members of ICA's board were named defendants in the *Shields* suit.

5. Under Federal Rule of Civil Procedure 23(e), the district court determines whether a proposed settlement is "fundamentally fair, adequate, and reasonable." *In re Pacific Enters. Sec. Litig.*, 47 F.3d 373, 377 (9th Cir.1995) (internal quotation marks and citations omitted). Rule 23.1 provides that a shareholder derivative action "may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association." Rule 23.1 also requires that "[t]he action shall

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the notice provided to shareholders was "the best notice practicable under the circumstances"; (2) the settlement was "the product of good faith arm's length negotiations"; and (3) the settlement was "fair, reasonable and adequate as to" ICA and the shareholders.

On the same day that Magistrate Judge McCue approved the settlement, the United States Office of Thrift Supervision ("OTS") ordered the seizure of ISA and placed it into conservatorship under the RTC. OTS Order No. 90-375 (Feb. 22, 1990). On February 28, 1990, ICA filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.

In its corporate capacity and as receiver for ISA, the Resolution Trust Corporation ("RTC") filed actions against the officers, as well as the directors and other executives of ISA, to recover damages for the losses suffered by ISA as a result of the imprudent transactions that took place between 1987 and 1989. On June 22, 1994, the district court granted the officers' and directors' motion for summary judgment on the two mismanagement claims (negligence and breach of fiduciary duty), concluding that the claims were barred by claim preclusion. Pursuant to Federal Rule of Civil Procedure 54(b), the district court entered judgments on the mismanagement claims in favor of Appellees Cypres, Davidson, Kline, Lea, and Maniscalco. The RTC timely filed notices of appeal.

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not be dismissed or compromised without the approval of the court." Fed.R.Civ.P. 23.1. "Before approving a class action settlement, the district court must reach a reasoned judgment that the proposed agreement is not the product of fraud or overreaching by, or collusion among, the negotiating parties." *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1290 (9th Cir.) (internal quotation marks and citations omitted), *cert. denied sub nom. Hoffer v. City of Seattle*, 506 U.S. 953, 113 S.Ct. 408, 121 L.Ed.2d 333 (1992).

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II

The doctrine of claim preclusion (res judicata) provides that a final judgment on the merits bars a subsequent action between the same parties or their privies over the same cause of action. *Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1518 (9th Cir.1985) (citations omitted). "The judgment prevents litigation of all grounds and defenses that were or could have been raised in the action." *Id.* (citing *Allen v. McCurry*, 449 U.S. 90, 94, 101 S.Ct. 411, 414-15, 66 L.Ed.2d 308 (1980)). The parties must have had "a full and fair opportunity to litigate." *Montana v. United States*, 440 U.S. 147, 153, 99 S.Ct. 970, 973, 59 L.Ed.2d 210 (1979).

This court has held that "when two parties are so closely aligned in interest that one is the virtual representative of the other, a claim by or against one will serve to bar the same claim by or against the other." *Nordhorn v. Ladish Co., Inc.*, 9 F.3d 1402, 1405 (9th Cir.1993) (citations omitted). Furthermore, "[c]orporate affiliations may be relevant in determining whether two parties are in privity for purposes of issue or claim preclusion." *Id.* (citing *In re Gottheiner*, 703 F.2d 1136, 1139-40 (9th Cir.1983) (defendant in prior suit was wholly owned by defendant in subsequent suit, and collateral estoppel barred second suit)).

In determining whether successive lawsuits involve the same cause of action, this court considers the following factors:

> (1) whether rights or interests established in the prior judgment would be destroyed or impaired by prosecution of the second action;
> (2) whether substantially the same evidence

> is presented in the two actions; (3) whether the two suits involve infringement of the same right; and (4) whether the two suits arise out of the same transactional nucleus of facts.

Nordhorn, 9 F.3d at 1405 (quoting *Costantini v. Trans World Airlines*, 681 F.2d 1199, 1201-02 (9th Cir.) (citation omitted), *cert. denied*, 459 U.S. 1087, 103 S.Ct. 570, 74 L.Ed.2d 932 (1982)); *see Costantini*, 681 F.2d at 1202 (citation omitted) ("The last of these criteria is the most important.").

A

Here, the district court held that claim preclusion barred the FDIC's mismanagement claims against the officers and director Cypres. The court concluded that although ISA was neither a named defendant in the *Shields* litigation nor a signatory in the *Shields* settlement agreement, ISA was nonetheless a party to the *Shields* action for the purposes of claim preclusion.

Emphasizing that ISA was a wholly-owned subsidiary of ICA, which was a named defendant and signatory in *Shields*, and that the boards of ICA and ISA were identical, the court reasoned that ICA was the "virtual representative" of ISA in the *Shields* action. *See Nordhorn*, 9 F.3d at 1405. The court bolstered this conclusion by observing that (1) as a financial holding corporation, ICA conducted its savings and loan business only through ISA (hence, "but for the existence of ISA, there would have been little or no ground for" the claims brought in *Shields*); and (2) the *Shields* settlement was approved in principle at a joint meeting of the boards of ICA and ISA on November 30, 1989.

Next, considering the factors outlined in *Nordhorn*, 9 F.3d at 1405, the district court concluded that the FDIC's mismanagement claims "were the same 'claim' for res judicata purposes such that the RTC [FDIC] is now precluded from asserting them here against these defendants." The court determined that the FDIC's mismanagement claims (invoking breach of fiduciary duty and negligence) were virtually the same allegations made in the *Shields* complaint. Both sets of allegations concerned imprudent investments, loan transactions, and leases between 1987 and 1989 by officers of ICA and ISA.

B

On appeal, the FDIC argues that the district court erred because (1) a genuine issue of material fact exists as to whether ICA was the virtual representative of ISA in the *Shields* settlement; and (2) the FDIC's mismanagement claims are different from the claims advanced by the shareholder plaintiffs in *Shields*. We are not persuaded.

1

The FDIC argues that "[t]he fact that one entity is a wholly owned subsidiary of another entity is insufficient to establish privity between the two entities for purposes of the defense of claim preclusion." The FDIC raises four major contentions in support of this argument.

First, the FDIC's contention that "[t]he parent/subsidiary relationship of ICA and ISA, though potentially relevant, is not dispositive" is unpersuasive in light of this court's clear holdings to the contrary. *See, e.g., Lake at Las Vegas Investors Group, Inc. v. Pacific Malibu Dev. Corp.*, 933 F.2d 724, 728 (9th

Cir.1991) (holding that "wholly-owned subsidiary and partnership in which that subsidiary is the general partner may invoke the two dismissals of the subsidiary's parent and claim Rule 41(a)(1) res judicata"), *cert. denied,* 503 U.S. 920, 112 S.Ct. 1295, 117 L.Ed.2d 518 (1992); *Gottheiner,* 703 F.2d at 1139-40 (defendant in prior suit was wholly owned by defendant in subsequent suit, and collateral estoppel barred second suit); *Sparks Nugget, Inc. v. CIR,* 458 F.2d 631, 639 (9th Cir.1972) (privity exists between a sole or controlling stockholder and its company), *cert. denied sub nom. Graves v. CIR,* 410 U.S. 928, 93 S.Ct. 1362, 35 L.Ed.2d 589 (1973); *see also Pollard v. Cockrell,* 578 F.2d 1002, 1008-09 (5th Cir.1978) (citation omitted) (the virtual representation doctrine contemplates relationships such as that between parent corporation and its subsidiary); *Greenberg v. Potomac Health Sys., Inc.,* 869 F.Supp. 328, 330-31 (E.D.Pa.1994) (litigation against parent barred subsequent claim against wholly-owned subsidiary).

Second, the FDIC's reliance on *Johnson & Johnson v. Coopervision, Inc.,* 720 F.Supp. 1116, 1123 (D.Del.1989), is unwarranted. In *Johnson & Johnson,* the district court stated in dicta that "[t]he fact that Iolab is Johnson & Johnson's wholly-owned subsidiary is insufficient to establish privity between the two entities" for the purposes of determining whether a litigant would be prejudiced by the failure to join Iolab as a necessary party to a suit against Johnson & Johnson. *Id.* at 1122-23; *see id.* at 1124 ("[i]t would be premature for this Court to endeavor to decide whether Iolab and Johnson & Johnson are in privity in bringing the instant action"). This dicta from a district court beyond this circuit is not persuasive authority for the FDIC's contention, especially considering that this court has held that "[c]orporate affiliations may be relevant in determining whether two parties are in privity for purposes of issue or claim preclusion." *Nordhorn,* 9 F.3d at 1405.

Third, the FDIC contends that ICA could not adequately represent the ISA's interests because ISA "was a federally insured savings and loan with separate and distinct duties to its depositors, insurers, regulators and creditors." Citing *General Rubber Co. v. Benedict,* 215 N.Y. 18, 109 N.E. 96 (1915),[6] the FDIC maintains that ISA "has separate derivative claims that it may pursue against its own officers and directors even though some of the same misconduct may also give rise to derivative claims on behalf of the parent company." This contention is without merit because ICA's role in the settlement would be meaningless without regard to the interests of ISA, through which ICA conducted the financial activities that were the subject of the *Shields* allegations. ICA was simply a holding company; the close alignment in interests between ICA and ISA is evidenced by the identical memberships of their boards.

Fourth, although the FDIC concedes that the *Shields* settlement was conditionally approved at a joint meeting of the ICA and ISA boards on November 30, 1989, the FDIC argues that only the ICA board gave the final approval to the settlement on December 15, 1989. This argument lacks significance, considering that (1) the ICA and ISA boards were identical in membership; (2) the parent ICA had the authority to bind its wholly-owned subsidiary ISA; and (3) the FDIC concedes that the ISA board, *qua* ISA board, reviewed the settlement and gave its approval (albeit conditional).

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6. Actually, *General Rubber* fails to support the FDIC's position, to the extent that the FDIC is bringing claims quite similar to those brought in *Shields*. "*General Rubber* . . . permits a parent company to sue the wrongdoer for breach of fiduciary duty, despite the fact that the subsidiary company may maintain an action against the same defendant for conversion. *This rule does not, however, permit a parent and subsidiary company to assert the same cause of action against the same defendant.*" *Sound Video Unlimited, Inc. v. Video Shack Inc.,* 700 F.Supp. 127, 137 (S.D.N.Y. 1988) (emphasis added).

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Moreover, the final judgment in *Shields* includes the following in its list of "Signatory Defendants": "Imperial Corporation of America, Imperial Savings of America[7] and all subsidiaries and affiliates of Imperial Corporation of America and Imperial Savings of America." Further, the *Shields* judgment states: "Imperial Corporation of America and Imperial Savings of America and related entities are collectively referred to as 'Imperial'."

Even viewing the evidence in the light most favorable to the FDIC, the FDIC has failed to raise a genuine issue of material fact as to whether ICA was ISA's virtual representative in the *Shields* litigation.

2

Next, the FDIC has failed to establish that its mismanagement claims are different from the negligence and fiduciary duties claims in the *Shields* action.

Although the FDIC concedes that "many of the same wholesale consumer loan transactions identified in the *Shields* litigation are present here," the FDIC nonetheless maintains that its mismanagement claims involve infringement of different rights, require different evidence, and do not arise out of the same transactional nucleus of facts.

In fact, the FDIC stresses the federal securities claims brought in *Shields,* while glossing over the pendent state law claims for relief, which alleged negligence and breaches of fiduciary duties in the context of imprudent loans, leases, and

7. Apparently, this is a typographical error. In any case, "all subsidiaries and affiliates of Imperial Corporation of America" clearly includes ISA.

other transactions. These claims closely resemble the FDIC's mismanagement claims. As an example of the shared transactional nucleus between the two suits, the complaints in both actions refer to the Global Motors loans.[8]

As the district court concluded, the FDIC's mismanagement claims "arise out of the defendants' alleged mismanagement of ISA during the period between 1987 and 1989 by, among other things, causing ISA to invest in bad consumer and auto loans and leases, and failing to establish adequate loan reserves. These are virtually the same allegations made in . . . the *Shields* litigation."

III

We also consider the FDIC's assertion that claim preclusion is inapplicable because its predecessor-in-interest, ISA, did not have a "full and fair opportunity to litigate" in the *Shields* action. The FDIC rests this argument on its contentions that ISA's interests were not adequately represented in *Shields* and that the *Shields* settlement was marred by conflicts of interest, material nondisclosures, and the imminent seizure of ISA by federal regulators. Although it is an open question whether the FDIC's accusations could form the basis of a potential claim for legal malpractice or fraudulent transfer,[9] the accusations

8. *See International Union of Operating Eng'rs-Employers Constr. Indus. Pension, Welfare & Training Trust Funds v. Karr*, 994 F.2d 1426, 1430 (9th Cir. 1993) (citations omitted) (noting that this court has "previously applied the doctrine of res judicata on the ground that the two claims arose out of the same transaction, without reaching other factors cited in *Costantini*").

9. Indeed, the FDIC has brought fraudulent transfer claims against ICA

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material nondisclosures, and the imminent seizure of ISA by federal regulators. Although it is an open question whether the FDIC's accusations could form the basis of a potential claim for legal malpractice or fraudulent transfer,[9] the accusations alone do not compel a finding that *Shields* failed to provide a "full and fair opportunity" for litigation.

After all, any one of ICA's shareholders could have brought such objections during the settlement approval process, but no one did. Instead of seeking direct review or filing a Rule 60(b) motion alleging fraud or misconduct within one year after the *Shields* judgment, the RTC (and, now, the FDIC) waited three years to raise these allegations of fraud, collusion, and deceit on the part of the *Shields* participants. *See* Fed.R.Civ.P. 60(b). Moreover, the FDIC has not demonstrated that Magistrate Judge McCue failed to enforce the procedural safeguards outlined in Federal Rule of Civil Procedure 23.1, which governs court approval of shareholder derivative actions.

In addition, we reject the FDIC's contention that *FDIC v. O'Melveny & Myers*, 61 F.3d 17, 19 (9th Cir.1995) (on remand from Supreme Court), stands for the broad proposition that equitable defenses may not be used against the FDIC as a receiver. In *FDIC v. O'Melveny & Meyers*, this court held "only that the bank's inequitable conduct is not imputed to FDIC" for the purpose of precluding the FDIC as receiver from bringing a legal malpractice action against the failed savings and loan

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directors, but these claims are not before us in this appeal. In addition, in a related appeal which we also decide today, the representative of ICA's bankruptcy estate has brought malpractice claims against ICA's attorneys for their role in *Shields*. *See Durkin v. Shea & Gould*, 92 F.3d 1510 (9th Cir.1996).

association's former counsel. 969 F.2d 744, 752 (9th Cir.1992), *rev'd*, __ U.S. __, 114 S.Ct. 2048, 129 L.Ed.2d 67 (1994). This court expressly cautioned that "it does not necessarily follow that equitable defenses can never be asserted against FDIC acting as a receiver." *Id.* at 752. The Supreme Court reversed, holding that state law, not federal law, governs whether corporate officers' knowledge of fraud can be imputed to the FDIC suing as a receiver. *O'Melveny & Myers v. FDIC*, __ U.S. __, 114 S.Ct. 2048, 129 L.Ed.2d 67.

The Court emphasized that "the FDIC is not the United States," *id.* at __, 114 S.Ct. at 2053, and that "[12 U.S.C.] § 1821(d)(2)(A)(i) places the FDIC in the shoes of the insolvent S & L, to work out its claims under state law. . . ." *Id.* at __, 114 S.Ct. at 2054; *see also id.* at __, 114 S.Ct. at 2055 ("there is no federal policy that the fund should always win"). The Court remanded to this court to resolve how California law applies to the issue of whether the savings and loan officers' knowledge of fraudulent conduct could be imputed to the FDIC as receiver. On remand, this court reached "the same conclusion as . . . last time." *O'Melveny & Myers*, 61 F.3d at 19 (republishing relevant language from *O'Melveny & Meyers*, 969 F.2d at 751-52, and noting, under California law, that defenses based on party's unclean hands or inequitable conduct do not generally apply against party's receiver). Accordingly, *O'Melveny & Myers* in no way compels the conclusion that claim preclusion is an invalid defense in an action initiated by the FDIC as a receiver.

IV

Finally, the FDIC contends that the only way that ICA could have asserted ISA's claims would have been by means of a double

derivative action.[10] Since the FDIC maintains that the *Shields* litigants did not observe the proper procedures for bringing a double derivative action, the FDIC argues that ISA's derivative claims were not advanced.

This argument is a red herring because claim preclusion clearly bars not only claims that were actually litigated, but also any claims that could have been asserted. *See Costantini v. Trans World Airlines,* 681 F.2d 1199, 1201 (9th Cir.), *cert. denied,* 459 U.S. 1087, 103 S.Ct. 570, 74 L.Ed.2d 932 (1982). Considering the FDIC's concession that the *Shields* plaintiffs could have brought a proper double derivative suit, it naturally follows that such claims are barred by claim preclusion. Furthermore, the *Shields* judgment plainly released any and all claims that could be brought against "present and former" officers. *See Class Plaintiffs v. City of Seattle,* 955 F.2d 1268, 1287-88 (9th Cir.) (upholding release of claims that were not alleged), *cert. denied sub nom. Hoffer v. City of Seattle,* 506 U.S. 953, 113 S.Ct. 408, 121 L.Ed.2d 333 (1992); *see also Matsushita Elec. Indus. Co., Ltd. v. Epstein,* __ U.S. __, 116 S.Ct. 873, 880-81, 134 L.Ed.2d 6 (1996) (holding that state court judgment settling shareholders' state and federal claims had preclusive effect in federal court even though shareholders could not have pressed their federal claims in state court).

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10. "A 'double derivative' suit has been defined as an action brought by a shareholder of a holding or parent company, on behalf of that corporation to enforce a course of action in favor of the subsidiary company. The shareholder is, in effect, maintaining a derivative action on behalf of the subsidiary, since the holding or parent company has derivative rights to the cause of action possessed by the subsidiary. The directors of both the parent and the subsidiary must refuse to enforce the cause of action." *Gaillard v. Nairmas Co.,* 173 Cal.App.3d 410, 219 Cal.Rptr. 74, 79 n. 7 (1985) (citations omitted).

Appendix G

V.

For the foregoing reasons, we affirm the district court's grant of summary judgment in favor of the ISA officers and director Cypres.

AFFIRMED.

APPENDIX H — FEDERAL RULE OF CIVIL PROCEDURE 23.1

Federal Rule of Civil Procedure 23.1:

> In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal

or compromise shall be given to shareholders or members in such manner as the court directs.